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BusinessWeek



STOCKS

WHY THE MARKET WILL KEEP GOING UP

The storm has passed, and the old rules of risk and reward are back

BY ROBEN FARZAD

STOCKS

WHY THE MARKET IS GOING NOWHERE

The old rules no longer apply, and a dreary decade lies ahead

BY ROBEN FARZAD

BusinessWeek

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For bulls, "It's time to grow up and become a chastened adult," says one expert

(COVER) CHRISTOPH NIEMANN; (TOP) CHRISTOPHER ANDERSON/MAGNUM

IN DEPTH

WHAT IS THE 'NEW NORMAL'?

040 | Where is the market headed? One set of seers predicts a long period of slow growth and new investing rules. Another group sees a return to historic patterns. Caught in the middle: Thousands of professional investors seeking the market's true north. |BW|

INVESTING IN RUSSIA: PERIL AND PROMISE

048 | Its economy is shrinking, inflation is high, and recovery will be slow. But Russia is big and rich, with vast reserves of oil, metals, and timber. Add in 140 million hungry, moneyed consumers, and it's no wonder multinationals can't stay away. |BW|

in SPECIAL REPORT: INSIDE INNOVATION

054 | In a book excerpt, Tim Brown, CEO of famed design shop IDEO, shows how change can originate with frontline staff, even at hospitals; plus a look at how designs for the disabled lead to mainstream products—from iPhones to YouTube. |BW|



VIKRAM PANDIT ON THE RECORD

Citigroup's CEO sits down with *BusinessWeek* Editor-in-Chief Steve Adler to discuss the bank's relationship with the government, the economy's future, excessive executive pay, and how to level the playing field. | BW | PAGE 064



GREEN APPLE?

Even with Al Gore on the board, Apple has a spotty reputation on environmental issues—but Steve Jobs is launching his most aggressive effort yet to boost its bona fides. | BW | PAGE 068

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Jack and Suzy Welch are off while Jack recovers from a back infection

(L TO R) DANIEL ACKER/BLOOMBERG NEWS; JEFF CHIU/AP PHOTO



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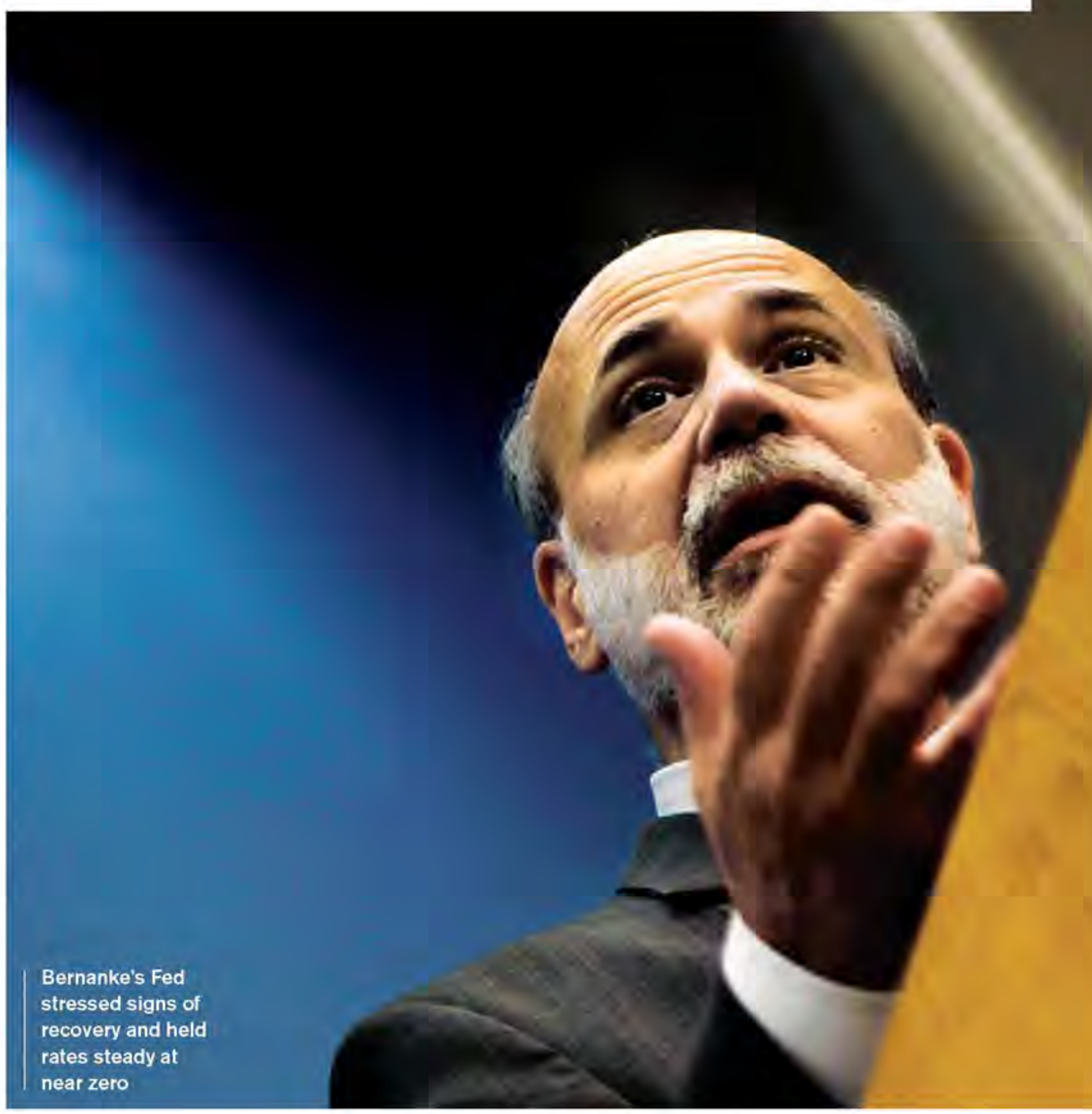
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ECONOMICS & POLICY

LOW RATES FOR A LONG TIME

Ben Bernanke's Fed is in no hurry to take the U.S. economy completely off life support, with recession-fearing doves still having the upper hand over inflation-fearing hawks. But the rate-setting **Federal Open Market Committee** did take a small step forward in its gradual exit strategy on Sept. 23, saying it will shrink its weekly purchases of mortgage-backed securities and mortgage agency debt, taking longer to amass its target total of $1.45 trillion. Those purchases are keeping a lid on mortgage rates. The FOMC voted unanimously to maintain its benchmark rate at zero to 0.25% and affirmed that "economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period."



Bernanke's Fed stressed signs of recovery and held rates steady at near zero

JIM YOUNG/REUTERS

THE G-20 AGENDA

As befits a scary financial crisis, the leaders of 20 of the world's biggest economies have spent lots of time together lately—the Pittsburgh summit scheduled for Sept. 24-25 is their third meeting in less than a year. But despite a packed agenda, analysts and officials were busy at press time downplaying expectations of any dramatic policy pronouncements. There's general agreement that banks should be required to keep bigger capital reserves, but Europe and the U.S. apparently remain at loggerheads on the specifics. There may be better prospects for an accord on reining in executive pay. Other topics of discussion: rebalancing global consumption and winding down stimulus programs.

FRACAS OVER THE WEB

Net neutrality: Behind that bland phrase lies a bitter battle. On Sept. 21, **FCC Chairman Julius Genachowski** proposed rules under which Internet service providers would be prohibited from blocking any users or applications and would have to reveal how they are managing their networks. The fight pits cable and telecom giants such as **Comcast** and **Verizon** against heavy Net users such as **Google** and **Skype.** Genachowski set the stage for another spat by insisting the rules should extend to "all platforms that access the Internet," including wireless carriers. Top **AT&T** lobbyist **James Cicconi** says the company will resist any bid to boost regulation of wireless in the "absence of any compelling evidence of

problems or abuse." The new regs will be formally proposed at an October meeting, where they're expected to prevail in a 3-2 vote.

"FCC Stirs Old Debate on 'Net Neutrality'" businessweek.com/magazine

STRATEGY

DELL'S BIG BUY

Ross Perot's Presidential ambitions may have fizzled, but in techland they still love his companies. Dell on Sept. 21 said it aims to buy computer service provider **Perot Systems** for $3.9 billion in cash, which amounts to a stiff 68% premium. Dell's move to expand its lucrative business of managing corporate networks comes just 16 months after rival **Hewlett-Packard** bought another former Perot services company, **EDS.** Investors questioned whether Dell is paying too much, but the PC maker figures it can cash in partly by delivering services to hospitals looking to digitize health records.

| BW | PAGE 017 "FaceTime: Mark Hurd of HP Isn't Resting on His Laurels"

TAX CLIMATE

U.S. states with the most and least business-friendly tax systems

	RANK
South Dakota	1
Wyoming	2
Alaska	3
Nevada	4
Florida	5
Iowa	46
Ohio	47
California	48
New York	49
New Jersey	50

Data: Tax Foundation

HIGH ROLLERS IN MACAU

The Chinese enclave of Macau has a hot hand again. Casino revenues leapt 17%, to a record $1.4 billion, in August as a big gaming palace opened and the Chinese government eased travel restrictions. As a result, casino operators are rushing to shore up balance sheets. **Melco Crown Entertainment,** controlled by Macau



Michael Dell between Ross Perot Sr. and Jr.: Dell paid dearly for Perot Systems

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010 EXECUTIVE SUMMARY

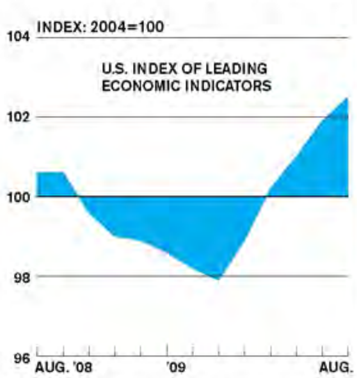

The City of Dreams casino: Macau moguls are raising big money

gambling scion **Lawrence Ho,** raised $200 million in a stock offering in August. Ho opened the $2.4 billion **City of Dreams** resort in June. Vegas mogul **Steve Wynn** aims to garner $1.6 billion in October by offloading a 25% stake in his Macau operations. But the biggest winner may be his Vegas rival **Sheldon Adelson,** who propped up his **Las Vegas Sands** last year by pumping in $1 billion of his own cash. Sands shares have shot from 1.40 to 19 in six months, and Adelson plans to offer shares in Sands' Macau subsidiary.

BANKS DO AN ABOUT-FACE

It must have seemed like a great idea earlier this year when banks were deep in the soup: Charge largely unsuspecting customers steep fees when they overdraw their accounts using a debit card. But the move proved a public-relations catastrophe, and on Sept. 22 and Sept. 23, respectively, **JPMorgan Chase** and **Bank of America** said they were changing course. They will eliminate fees for small overdrafts, cut the number of fees a customer can be hit with on any given day, and allow customers to opt out of overdraft protection. The new policies will be fully in place by sometime during the first quarter of 2010. They mirror changes already mandated for credit cards under the **Credit Card Act** of 2009.

SUSTAINED IMPROVEMENT



Data: The Conference Board

LUXURY HEADS ONLINE

After years of giving the Web a cold shoulder, luxury brands are embracing e-commerce and social media—though more out of necessity than conviction. A year ago only 33% of upscale brands were flogging their wares on the Web; now 66% are. But when it comes to strutting their stuff, most purveyors of luxe are as wobbly as a runway model on six-inch spikes, according to a new report from Scott Galloway, a marketing professor at **NYU's Stern School of Business.** Galloway rated brands on their "digital IQ" and found that makers of consumer electronics, such as **Apple**, and carmakers, such as **BMW**, exhibit the most savvy. On the other end of the scale, cosmetics, hotels, and cruise lines figured prominently as brands that are committing too little resources to building a Web presence.

NYU Stern School of Business

TECHNOLOGY

INTEL VS. EC, ROUND XIV

Message from **Neelie Kroes** to Intel: Be careful what you wish for. On Sept. 21, Europe's competition commissioner released documents detailing e-mail exchanges from PC makers and Intel employees that suggest the chip behemoth strong-armed manufacturers into shunning chips from rival **Advanced Micro Devices.** The release comes as Intel is challenging a record $1.45 billion antitrust fine the EC leveled in May. Intel says European regulators set out from the start to find Intel guilty with little evidence to back up their conclusion. **CEO Paul Otellini** called publication of the

The EC's Kroes released e-mails supporting her antitrust charges against Intel



(FROM TOP) DANIEL J. GROSHONG/BLOOMBERG NEWS; JOCK FISTICK/BLOOMBERG NEWS

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e-mails "salacious" and inflammatory and insists regulators are withholding evidence that will prove Intel innocent. The company is under court order not to release documents it says would aid its defense.

FINANCE

WHO KNEW AT DEUTSCHE?

Deutsche Bank weathered the financial crisis better than many peers, but now its reputation is taking a drubbing from an expanding scandal. *The Wall Street Journal* reported on Sept. 22 that **Supervisory Board Chairman Clemens Börsig** knew more than the bank has acknowledged about using private detectives to snoop on a critical shareholder. Börsig was briefed on the operation, though it's unclear whether he O.K.'d it, the *Journal* said, citing an internal report commissioned by Deutsche from law firm **Cleary Gottlieb Steen & Hamilton.** A spokesman said the bank stands by statements that top brass did not authorize any questionable activities.



Deutsche Bank's Börsig was briefed on a spying operation, says a report

BETTING ON AIG

Shares of the stricken insurer, in hock to the feds to the tune of $183 billion, surged 23% on Sept. 21. Reason: news that Washington may yet again ease the terms of the monster bailout, largely because the company is in no position to make the payments soon coming due. It would be the fourth revision to the deal struck last September, when AIG nearly went bankrupt. A **Government Accountability Office** report released on Sept. 21 said that the company's financial situation had stabilized but that it may never be able to repay the taxpayers.

LEADERSHIP

A DEPARTURE AT PEPSI

CEO Indra Nooyi is losing the executive she once described as her "closest partner," **Vice-Chairman Michael White,** 57. PepsiCo said on Sept. 19 that he'll leave the company by yearend. White, a rival to Nooyi when she got the top job in 2006, has been running the food and soda giant's international unit, which under his aegis has ballooned to a nearly $20 billion business. He also led Pepsi's negotiators in its recently announced $7.8 billion deal to buy two of its largest bottlers.

IDEAS THE JOYS AND PERILS OF 'REVERSE INNOVATION'

More global companies, from **General Electric** to **Procter & Gamble,** are adopting the strategy of "reverse innovation"—that is, turning products created for emerging markets into low-cost goods for developed-world customers. They're running into thorny management challenges. The new approach, also known as "trickle-up innovation," can require taking apart entire organizational structures—a difficult exercise that risks alienating established managers.

In an article in the October issue of the *Harvard Business Review*, **GE CEO Jeffrey Immelt** and **Tuck School of Business** professors **Vijay Govindarajan** and **Chris Trimble** lay out the lessons GE has learned from its trickle-up tactics, first deployed in the early 2000s when the company began turning away from the popular "glocalization" model of taking products for the U.S. and tweaking them for customers in developing countries. The authors suggest creating local teams that operate like independent new businesses but report to senior executives at headquarters to ensure top-level support.

GE, for one, has reaped rewards from such a strategy. Its six-year-old worldwide portable ultrasound business, stemming from products originally designed in and for China, saw growth of 50% to 60% a year before the recession. GE's overall Chinese revenue is on track to grow 25% this year, even in the downturn. The authors attribute these impressive numbers not only to the reverse innovation concept but also to a new management system that encourages it.

Harvard Business Review



Immelt with an ultrasound machine, a product line created for China

(FROM TOP) ARNE DEDERT/DPA/LANDOV; SAUL LOEB/AFP/GETTY IMAGES


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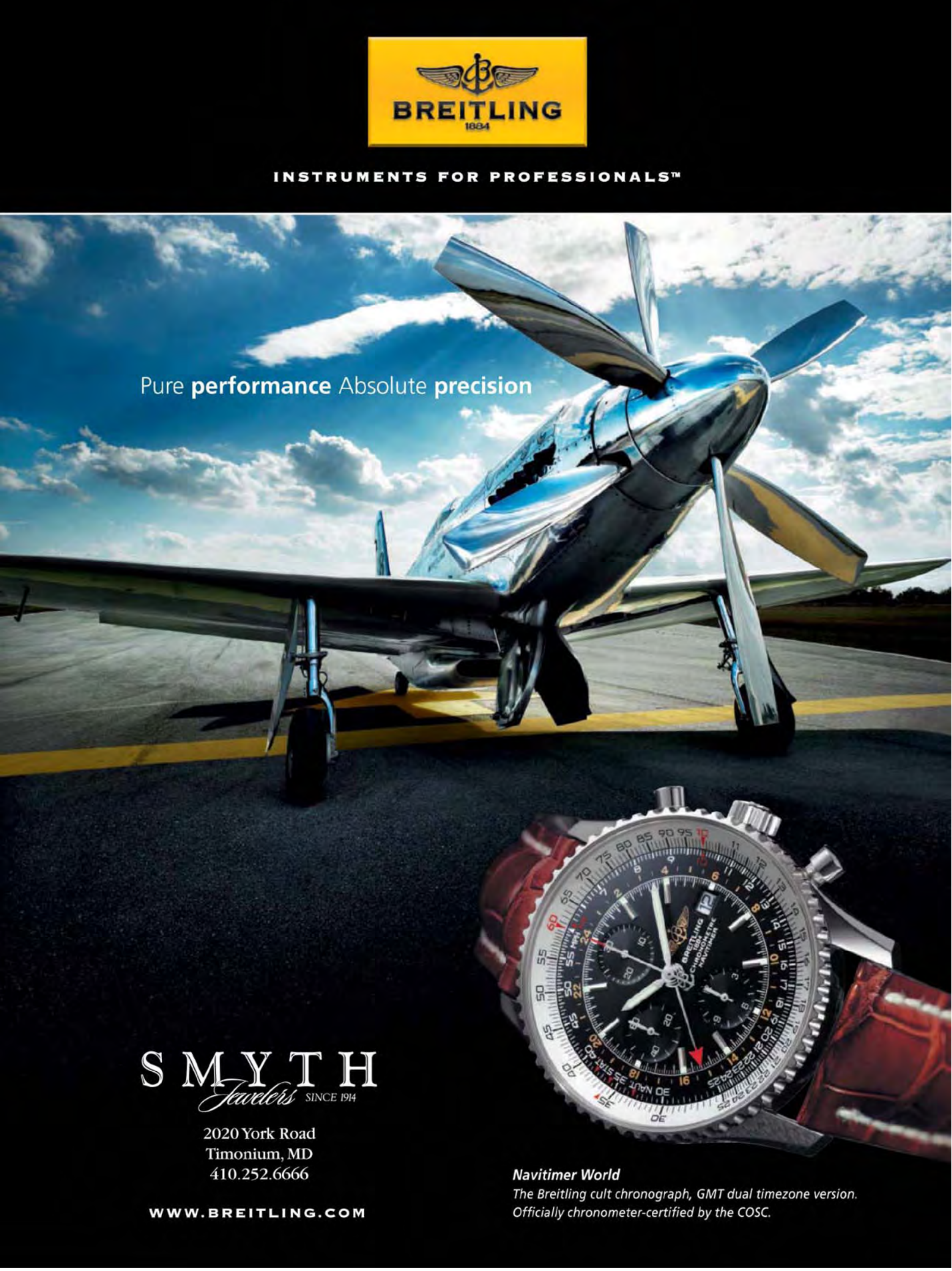
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(TOP) BRAD TRENT; (BOTTOM) DAVID KLAMMER/LAIF/REDUX

MARK HURD OF HP ISN'T RESTING ON HIS LAURELS

On the eve of a Hewlett-Packard meeting with Wall Street analysts, I talked with CEO Mark Hurd about how the company—now the largest in all of techdom—has weathered the downturn and where growth lies in the months ahead. Hurd also discussed HP's integration of tech services company EDS, which it bought last year for $13.9 billion. The man whom another business magazine recently called the most competitive chief executive on the planet drew a distinction between HP's strategy and that of Dell, which just announced its intent to purchase tech servicer Perot Systems.

MARIA BARTIROMO
What do you think of Dell's $3.9 billion acquisition of Perot Systems?

MARK HURD
When I look at the overall deal, I think it's a strong validation of the strategy we've executed. And we look forward to seeing them in the marketplace.

With the Dell-Perot deal, IBM buying PricewaterhouseCoopers, you see tech services becoming a key driver of sales. Can HP turn EDS into an effective catalyst for the whole company? Can HP become as strong in services as IBM?
I think HP is a global leader in services right now. I believe in the long run the alignment of service and technology companies is key. So, yes, EDS can help catalyze sales. But at the same time, it's HP's innovation that can automate

processes. What we've done is work very hard to build out the infrastructure part of our business—PCs, servers, storage, networking. We believe there's tremendous leverage across each of those categories because they share so many common parts. Then we wanted to leverage software on top of that infrastructure. So we've built the sixth-biggest software company inside Hewlett-Packard—software for server management, storage management, network management, data-center management. And it was critical for us to align the services capability on top of that software capability. We can deliver that infrastructure to a customer from the cloud, from a data center—any way they choose. When you buy a services company in isolation, that's one decision. It's not what we did.

Do you see evidence of increasing IT budgets, of more money being spent on services as we head toward the end of the year and as companies put together their 2010 budgets?

The thought that companies created a 2009 budget and in the middle of the year there's a catalyst to change that direction is probably not an appropriate thought at this point. The bigger question is what 2010 will look like. One thing is for sure, business's overall IT infrastructure has aged a year. It was not replaced at the normal rate. So I think you'll see more IT spending in 2010 than you saw in 2009, but I think we're going to have to wait a couple months and see how this economy fares in the fourth quarter before we can really know what next year will bring.

Some people have suggested that the overall HP game plan was devised by your predecessor, Carly Fiorina, and then executed with insane efficiency by you. Do you agree with that?

Oh, not at all. To be very blunt, I get too much credit in many respects for a lot of stuff. But this is not about my predecessor. This isn't about me. This is about a lot of folks. To build a company of our scale requires a lot of talent, and there are a lot of quality people in this company. To attribute the success of Hewlett-Packard to any one person is simply a mistake.



Carly Fiorina is said to be mulling a run for the Senate seat held by Barbara Boxer of California

> This isn't about me. ... To attribute the success of Hewlett-Packard to any one person is simply a mistake

If Carly runs for a U.S. Senate seat, will you vote for her?

I don't know where she stands on the issues. So if she's running for an office, I'd have to understand what she plans to do and what her agenda is, just as I would try to understand [the agenda of whomever] she was running against. And I don't have any of that data right now.

***Newsweek* just named Hewlett-Packard the top green company in the tech industry. Where do you stand on the carbon cap legislation that was passed by the House and will soon be considered by the Senate? As *BusinessWeek* writes this week, it has created a deep divide within the business community.**

Well, I don't know. I mean, I have to get educated on the legislation. I would tell you this: It is a big deal to us to be environmentally friendly. We think it's not only good for the environment but it's just good business. For example, we've figured out how to have printers not consume power while idle. And there are hundreds of these innovations across HP, all designed to reduce our footprint or reduce the power that's consumed. So we're really proud of this recognition.

MANAGING FORWARD
THE RESET ECONOMY
Getting ready for the post-recession world

Analysts have given your team credit for keeping very tight control over expenses during the downturn. Now what's your plan to get the top line growing again as the economy recovers?

We've fully integrated EDS into HP. We've got a very strong [product] portfolio sitting in a market that's ready for replacements in 2010. I would expect 2009 to end with R&D innovation roughly at the same level as it was before this started, if not a little higher. We have a lineup of new products that's as strong as we've ever had. We have a sales organization that's the same size or maybe slightly bigger than before [the downturn]. Plus we have a services organization we never had before and R&D as focused as it was before this started. |BW|

Maria Bartiromo is the anchor of CNBC's Closing Bell and writes the blog, Maria Bartiromo's Investor Agenda, at http://investoragenda.cnbc.com

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BUSINESS IS LEAN, FIT, AND READY TO GROW

Outside of finance, corporate balance sheets are rock-solid, and companies will be able to respond quickly as business conditions improve in the second half

The debate over the strength and durability of the recovery remains intense. Even if the current upturn mimics past norms, in which strong recoveries follow severe recessions, many analysts still believe a surprisingly solid second half won't prevent the economy from faltering in 2010. The big worry, of course, is consumers and the lack of income needed to repair their ragged finances.

What gets overlooked, however, is the totally opposite state of affairs in the business sector, which may be more important to the recovery's trajectory than household balance sheets. American corporations have rarely if ever emerged from a recession so lean, financially fit, and ready to respond to growth. That's important, because companies do the hiring, and their ability and willingness to expand is a crucial gear in the economy's growth machine.

Businesses were already trim heading into the recession: After the 2001 downturn, both payrolls and capital spending grew at the slowest pace in any post-recession period. Then came the cost-cutting frenzy of the past year, allowing profits to turn up strongly in the second quarter, based on Commerce Dept. data, even as overall domestic demand fell. With demand set to grow at least modestly in the second half, the upturn in profits will continue. A decisive return to profitability was a key feature of the recoveries from the severe recessions of the 1970s and 1980s.

19.3%

Profit growth for nonfinancial corporations, first quarter to second quarter, annual rate

Data: Commerce Dept.

Outside the finance sector, the rock-solid condition of corporate balance sheets was clear from the Federal Reserve's latest data. One standout factoid: Nonfinancial companies in the second quarter had a $156 billion surplus of cash flow relative to their capital spending, a surfeit that allows companies to finance all of their current outlays for equipment and construction without borrowing (chart). Except for 2005, when companies were allowed a one-time repatriation of foreign earnings at a reduced tax rate, that is the largest surplus on record.

Many businesses are already investing some of that cash in new equipment as they ramp up output in response to firmer demand and skimpy inventories. Both orders and production of business equipment have turned up in recent months. Outlays for new construction are sure to remain depressed, but spending for equipment appears to be rebounding faster than in past recoveries. Historically, growth in capital spending and hiring have been tightly correlated.

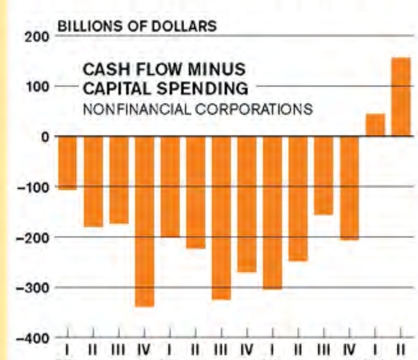
Through the second quarter, much of the more than adequate cash flow of nonfinancial corporations went to beefing up their holdings of financial assets. Since the end of last year, the ability of liquid assets to cover short-term liabilities has increased back to the record levels that existed prior to the recession.

Companies also have taken advantage of the rallies in the stock and bond markets. They have eliminated a lot of short-term debt, replacing it with more predictable long-term obligations at a low fixed rate. The annual rate of corproate bond issuance averaged $488 billion in the first half, up significantly from $141 billion in the second half of last year. Plus, corporations became net issuers of stock in the second quarter for the first time in seven years, eliminating the drain on cash flow from stock buybacks over that period.

Of course, none of this matters for hiring unless businesses can count on stronger revenues. However, recent data suggest demand, especially by consumers, looks stronger than expected. August retail sales jumped 2.7%, and the surprise was the breadth of the gains outside of the cash-for-clunkers boost. Rising housing starts suggest homebuilding will contribute positively to growth for the first time in 3½ years. Exports are rising, and government outlays certainly will increase.

As business conditions improve, with companies able to respond quickly, more hiring will not be far behind. Income is always the chief driver of consumer spending, and once jobs begin to turn up, consumers will not likely cause the recovery to falter. | BW |

A GROWING SURPLUS TO FUND FUTURE EXPANSION



Data: Federal Reserve, IHS Global Insight

PHOTOGRAPH BY BRAD TRENT; CHART BY DAVID FOSTER

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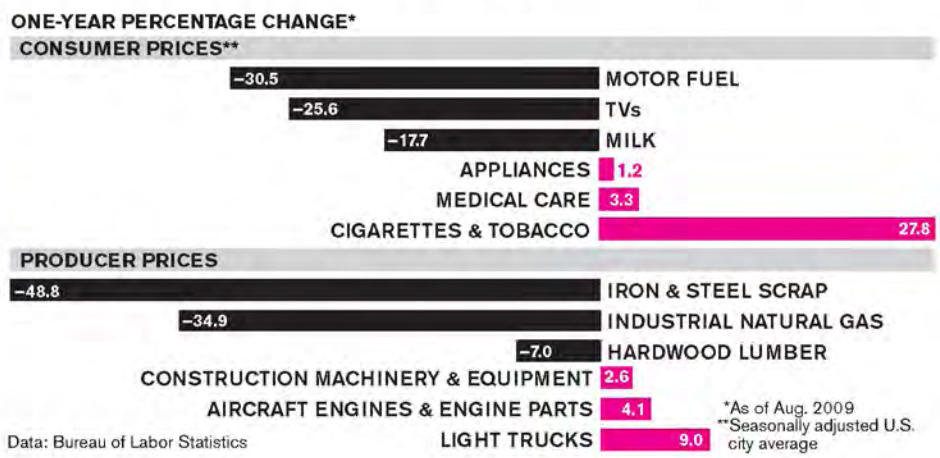
NUMBERS

PUT INFLATION FEARS ASIDE, FOR NOW

By Tara Kalwarski/Charts by Laurel Daunis-Allen

Despite jumps in commodity prices and central banks' easy money policies, inflation remains tame so far. Prices of goods and services in August were lower than a year earlier. Price increases for non-energy services are the lowest on record. Among major cities, only San Francisco saw prices rise over the past year.

Sizing Up Goods: One-year price changes for products purchased by individuals and businesses have varied widely.



*As of Aug. 2009
**Seasonally adjusted U.S. city average

Data: Bureau of Labor Statistics

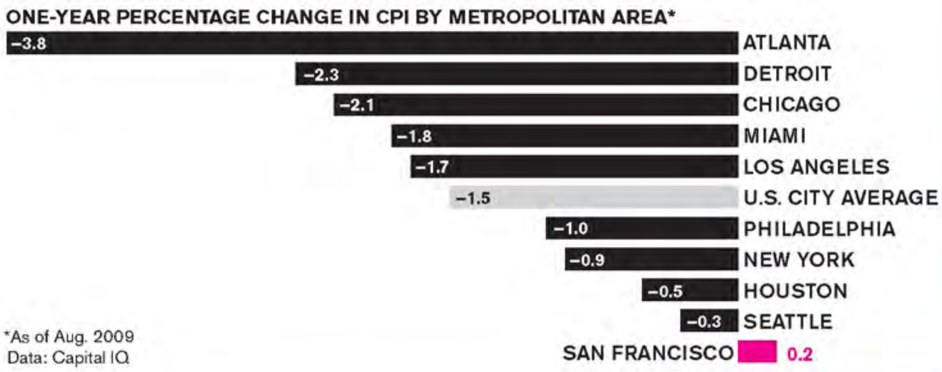
HIGHS AND LOWS

The year-over-year change in prices for nonenergy services has declined to the lowest rate on record, while annual price increases on core goods remain near a 10-year high.



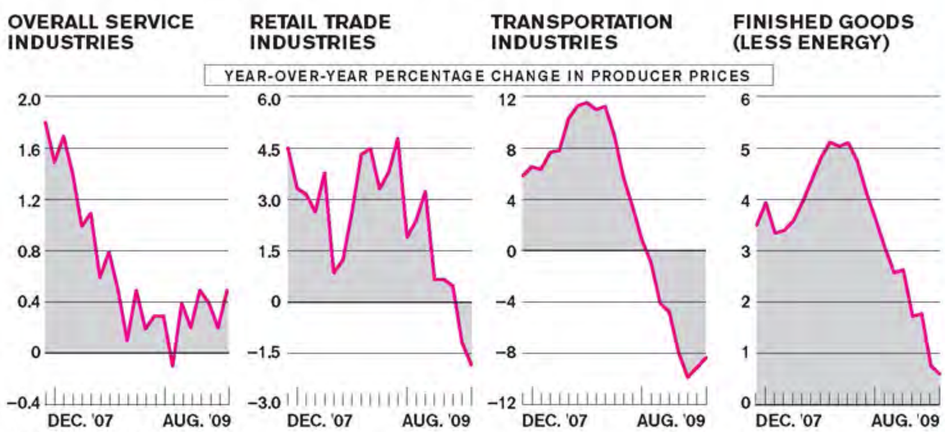
Data: Bureau of Labor Statistics

Regional Shifts: Consumer prices have fallen most steeply in Atlanta and Detroit, while San Francisco has experienced an uptick over the past year.

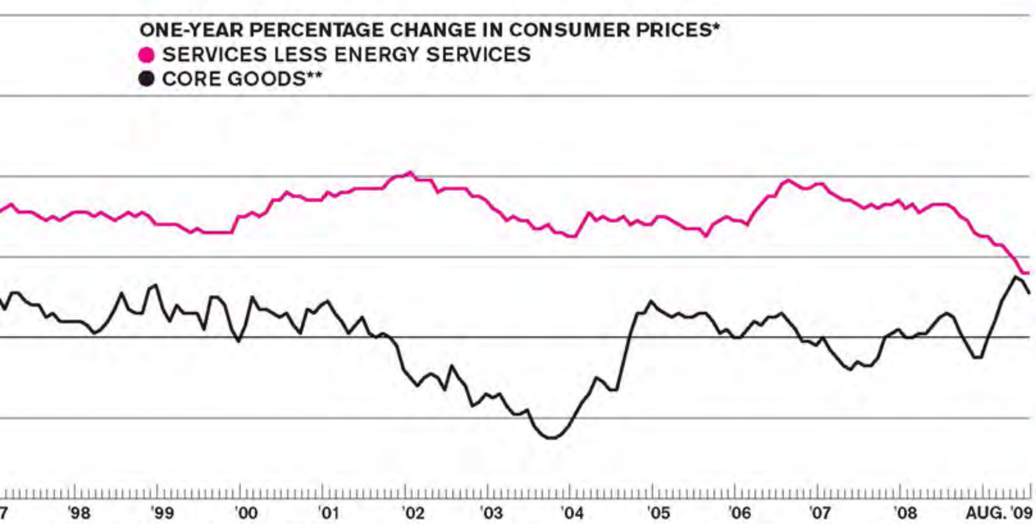


*As of Aug. 2009
Data: Capital IQ

Service Industries: Businesses across different service industries have seen inflation decline—more in some than others.



Data: Bureau of Labor Statistics



*Seasonally adjusted U.S. city average **Excludes food and energy commodities

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BTW

EDITED BY DEBORAH STEAD



AN INSTANT CHILD TO DISPLAY ON YOUR DESK

Not everyone is a fan of family-friendly workplaces. About 20% of employees surveyed by staffing firm Adecco, for instance, grumbled that they often pick up the slack for co-workers juggling children and career. Add some wit to that resentment, and you get TheOfficeKid.com, which offers childless workers who want to duck out early a visible excuse of their own. Launched in August by Melissa Maher, who works in advertising in New York, and two of her industry buddies, the site offers a $19.95 kit containing a framed snapshot of a child (you choose the gender and ethnicity) plus adorable artwork (drawn by Maher with her left hand). Maher, 30, says her own experience as a kidless colleague spurred her to create the kit as a gag gift. A few working mothers find it offensive, she acknowledges. Undeterred, she now offers two $10 extras: a kids' sports team picture (your face Photoshopped in as the coach) and a doctor's note on "official" stationery. *–Matthew Boyle*

Maher's kit is for workers who don't have an excuse to leave the office early



WHERE THE U.S. IS SLIPPING IN TECH

The U.S. is still the best place to run a tech company, according to a new study. But in some key ways of measuring competitiveness, the nation is vulnerable, industry experts say. "We see a number of factors where the U.S. is not in the lead," says Robert Holleyman, chief executive of Washington (D.C.)-based Business Software Alliance, which commissioned the annual study, now in its third year.

Released on Sept. 17 by the Economist Intelligence Unit, the report ranks 66 countries in six categories—including general business climate and the availability of a tech-literate workforce. While the U.S. topped the survey overall for the third year in a row, it was No. 1 in only two categories (table). It dominated the "human capital" indicator on the strength of its university graduates and came in first in "legal environment." But it lags behind four countries in the important R&D component and was in sixth place for infrastructure, a measure of broadband penetration. "As we start to see money from U.S. stimulus efforts related to broadband, we may start seeing an improvement," Holleyman says.

The survey's biggest surprise? Finland, home of Nokia, rose from No. 13 to No. 2, the spot held last year by Taiwan, which fell to No. 15. The switch occurred in part because of a more accurate count of IT patents. (The study previously estimated the registrations.) Rounding out the ranking's top five: Sweden at No. 3, followed by Canada and the Netherlands. *–Arik Hesseldahl*

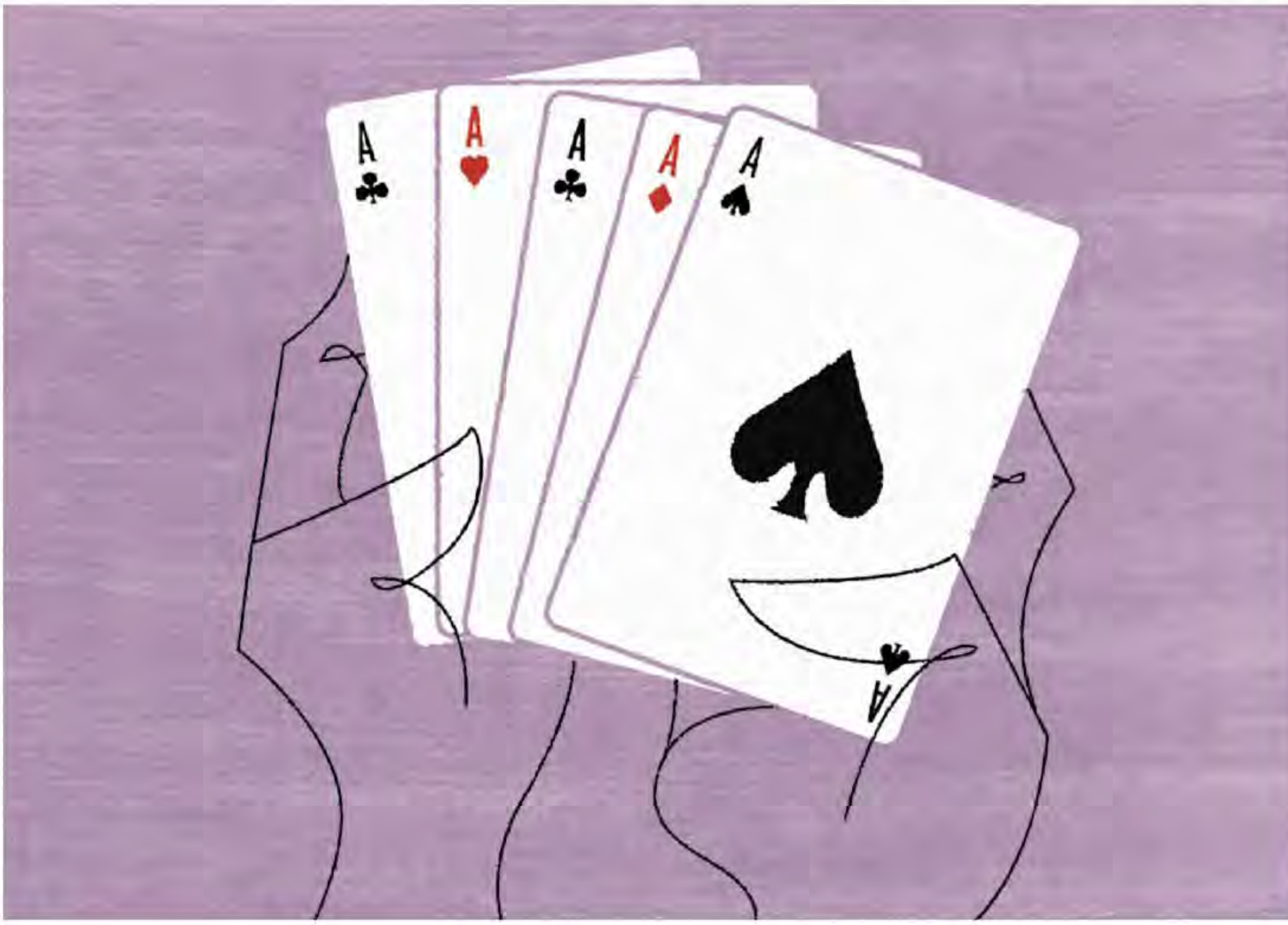
AND THE WINNERS ARE ...

Key components of the 2009 IT Competitiveness Index

CATEGORY	NO. 1
R&D	Canada
Infrastructure	Denmark
Human Capital	U.S.
Support*	Norway
Legal Environment	U.S.
Business Climate	Finland

*Includes government policies
Data: Economist Intelligence Unit

ILLUSTRATION BY FRANK CHIMERO; PHOTOGRAPH BY DAVID RUDES/BW



FRANK CHIMERO

WHEN PEOPLE RECKON IT'S O.K. TO CHEAT

Perhaps because of the cheating uncovered in the aftermath of the financial crisis—the lies told by everyone from mortgage lenders to Bernie Madoff—behavioral economist Dan Ariely has been getting a lot of calls about the nature of dishonesty. Ariely, a Duke University professor and author of the best-selling book *Predictably Irrational*, has spent years studying the topic.

Ariely says he's not surprised that derivatives—whose values are based on other financial assets—have gotten a bad rap. He has found that people are more likely to cheat if they are a step removed from the cash payoff. In one experiment, he paid subjects (whom he allowed to report their own scores) for correctly solving math problems—some in cash, some in tokens to be redeemed across the room. The second group exaggerated their scores twice as much as the first. Similarly, in studies of real-life expense reports, he found managers pad expenses more when their assistants compile the report. Such detachment, Ariely says, may be what's involved "when you backdate a stock option."

His most recent experiment—on deception's slippery slope—was inspired by some Prada swag he got after speaking at a conference last year. Carrying a genuine luxury bag made the fashion-challenged economist "feel different," he says, leading him to wonder about the psychological effects of sporting a counterfeit.

In an experiment involving 500 people, he found that subjects who knowingly wore fake Chloé sunglasses later cheated more than twice as often on an unrelated task than those assigned to wear the authentic designer goods. "If you take that first step, your self-image changes," he says. "It becomes easier to do the next dishonest thing."

Ariely's new obsession is how to prevent cheating. Consider the math task with the tokens. In one variation, testing participants first on their recall of the Ten Commandments eliminated cheating on the math scores. Then there's the study Ariely did with an auto insurer: Car owners who signed their names at the top of the insurance application, he found, were more honest about their driving habits, even though higher annual mileage meant higher premiums.

"We all like to think of cheaters as evil people," Ariely says. But deterrence can be as simple as reminding people of their better selves. His advice to the IRS for next tax season: Move the signature line to the top of the form. *–Ellen Gibson*

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034 Heavy turbulence at US Airways
036 Fill 'er up—with hydrogen



TECH: THE RETURN OF RISK-TAKING

Suddenly, there are mergers and acquisitions, IPOs, and investors galore. Will the reenergized industry lead the U.S. out of the Great Recession?

By Spencer E. Ante

In the past few weeks, Jon A. Woodruff, who heads up technology mergers and acquisitions in Goldman Sachs' San Francisco office, has seen the mood shift in Silicon Valley. Tech companies are stepping up their dealmaking after a quiet year. In a span of 21 days, Goldman has worked on three major deals—eBay's sale of Skype, Adobe's purchase of Omniture, and Dell's acquisition of Perot Systems. "People seem more willing to take out their checkbooks again for the right assets," says Woodruff.

The surge in deal activity is a sign of broader change: Risk-taking is making a comeback in the tech industry. The first three weeks of September saw $19.3 billion in technology mergers and acquisitions, up from $2.5 billion in August and $11 billion last September, according to Thomson Financial. Meanwhile, more companies are filing for initial public offerings, including such closely watched startups as Watertown (Mass.) battery maker A123 Systems. Venture capital investments are perking up, too. The microblogging service Twitter has raised a round of funding that gives the nearly revenue-free startup a valuation of $1 billion, according to several reports.

All this activity is being driven by a central idea: The worst of the recession is over, and it's time to prepare for better times. Economists and other experts say many corporations put off technology investments during the downturn and are likely to step up spending to generate the productivity gains vital to the bottom line. Mark M. Zandi, chief economist of Moody's Economy.com, predicts that tech spending in the U.S. will increase 4% in 2010 and 10% in 2011, after dropping 10% this year. "I think we are at a turning point for tech," he says.

$19.3 billion

Value of tech mergers and aquisitions worldwide so far in September, up from $11 billion in September a year ago

Data: Thomson Financial

If that's true, it bodes well for the overall economy. Zandi says that so many other important sectors of the economy, including finance and real estate, remain troubled that technology is one of the few industries that can bolster the U.S. recovery. In addition, since consumer spending is likely to remain weak, economic growth will hinge on business investment and exports, two areas driven by technology.

There are almost certainly more deals to come, say bankers, tech executives, and investors. Many tech companies have strong balance sheets and the cash flow to finance acquisitions. Credit markets are improving, which should lubricate the deal flow. Most important, buyers and sellers are finding it easier to agree on price. Earlier this year, with their stock prices at long-term lows, companies were reluctant to sell. Today buyers want to strike before asset prices run up any more. "Now that valuations have come back a bit, the value perceptions of buyers and sellers are a little more aligned," says eBay President and CEO John Donahoe.

RICHARD MIA



Dell's deal for tech services provider Perot Systems on Sept. 21 is one example of the shift in psychology. Dell executives say they began talking to Perot Systems Chairman Ross Perot Jr. about a deal in 2007, but Dell also held discussions with other tech services providers, and many were holding out for better prices. Negotiations with Perot heated up over the summer as the stock market surged. Ultimately, Dell paid a 68% premium for Perot, and it will still be able to pay the entire $3.9 billion purchase price in cash thanks to its flush balance sheet.

CHECKBOOK AT THE READY

Chairman and CEO Michael S. Dell said the price was justified and Perot will help fuel Dell's growth and strengthen its competitive position. In the meantime, Dell is considering additional deals and keeping its checkbook handy. "There's more we can do in service, there's more we can do in hardware, and there's more we can do in software," said Brian Gladden, Dell's chief financial officer.

Bankers and analysts point to other tech segments that look ripe for mergers and acquisitions. Especially hot, says Scott Kessler, an equity analyst at Standard & Poor's, are semiconductor equipment makers and software companies that deliver products over the Web, including Taleo and SuccessFactors. He adds that small to midsize software companies such as Tibco Software and Sybase could also be targets. Amity Millhiser, partner and practice leader of PricewaterhouseCoopers' Silicon Valley transaction services group, says would-be buyers are on the hunt. "Tech companies are really jumping in [to look for deals]," says Millhiser. "There's a lot of pent-up demand."

Sebastian Thomas, head of U.S. technology research for RCM Capital Management, which manages $13 billion in assets, says developments such as cloud computing will likely push giants such as Cisco or EMC to shop for storage, networking, and systems management technology. Brocade Communications Systems, 3PAR, BMC Software, Riverbed Technology, and Blue Coat Systems could all attract suitors, says Thomas.

Newfound optimism is beginning to spill over into other segments of the economy. There have been nine consecutive weeks in which companies have filed the paperwork for IPOs, the longest streak in a year. Among the companies with upcoming offerings are hotel enterprises, retailers, makers of consumer goods, and a pork processor looking to raise $2 billion. Overall, mergers and acquisitions are down about 40% from a year ago, but a few pockets of growth are emerging. This month, deal volume is up from a year earlier in the consumer staples, real estate, telecom, health-care, and media and entertainment industries. Says Zandi: "Slowly but surely confidence will build across the economy." | BW |

–With Aaron Ricadela and Cliff Edwards in San Francisco

"I think we're at a turning point for tech," says economist Zandi. He sees tech spending up 4% in 2010 and 10% in 2011

028

THE REAL ESTATE DRAG ON GE

Why losses at its commercial property unit could continue even after the market stabilizes

By David Henry

In 2008, the first full year of the recession, General Electric's commercial real estate business made a $1.1 billion profit. Now, even with signs of the broader economy improving, analysts estimate it could be five years before the unit earns another cent.

Such is the nature of economic downturns for investors in office buildings, apartment complexes, and shopping centers. Commercial real estate tends to be the last industry to lose money and the last to recover. What's different now is that players such as GE that didn't take too many risks will find themselves stuck in the quagmire of excess space, falling rents, and tighter credit even after demand picks up. While rental rates and property values should turn around in 2011 and 2012, analysts figure GE's portfolio may suffer at least until 2014. "There is a dramatic lag effect," says C. Stephen Tusa Jr., an analyst at JPMorgan Chase. "They are going to take their lumps." He estimates GE's properties will lose $8 billion in value through 2012.

As one of the biggest real estate investors in the world, GE is a proxy for what ails the market. "If you were a dominant player, you've got problems," says Paul M. Fried, a managing director at investment bank Traxi. Like many, GE doubled its bets in the last two years of the boom as lending standards slipped. By the end of 2008 the company owned 3,200 properties and held the loans on an additional 4,800, altogether worth some $84 billion as of June—more than all but Wells Fargo and Bank of America, according to research firm SNL Financial.



Now GE is crashing along with the rest of the industry. Delinquent and bad loans climbed sharply to 2.9% in June from 0.4% in December. The weakness will weigh on the entire company. (The unit, which is currently losing money, accounted for 18% of profits at GE Capital in 2007.) To deal with losses and potential regulatory requirements, GE may have to raise $40 billion in additional capital, estimates Nicholas P. Heymann, an analyst at research firm Sterne, Agee & Leach. GE acknowledges the unit will lose money this year but says that it won't need extra capital.

GE is locking in recession-era rents to fill vacancies in office buildings, low rates it could be stuck with for 5 to 10 years

GE's losses likely will continue long after commercial real estate stabilizes. Why? As old leases come up for renewal, GE and other owners are reluctantly locking in recession-era rents to fill vacant spaces. U.S. office rental rates, which hit $24.65 per square foot in 2008, will fall to $21.34 in 2011, estimates Victor Calanog, research director at Reis, a real estate data firm in New York. Players such as GE will be stuck with those low rates for a while since leases on office space run for 5 to 10 years. That means even when market rents start to rise, GE can't hike rates until current contracts end.

Meanwhile, the values on GE's properties continue to slide. It paid $2.2 billion for a set of office and other commercial buildings in Canada at the peak of the market. Among them: a 259,000-square-foot building in midtown Toronto whose vacancy rate is nearly 30%. The properties are worth about 25% less today.

PAYING CASH

GE can weather the storm better than its peers. "We are a real estate company, as opposed to a bank," says GE spokesman John Oliver. "We're better off in the sense that we're not afraid to have these assets on our books." For one thing, some 95% of its loans are first mortgages. When borrowers fall into foreclosure, the company recoups its money before others.

GE also owns roughly 87% of its buildings outright, meaning it didn't rely on a partner or a mortgage to buy the property. By paying cash, GE con-

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Can today's environmental thinking inspire tomorrow's technology? Toyota believes so. Since its launch, the Prius has earned the love of millions of forward-thinking drivers. We estimate our hybrid technology has saved a billion gallons of gas and lowered CO_2 emissions by billions of pounds.* It's also paving the way for the next generation of environmental vehicles. Like cars charged at home. Or cars that will run solely on electricity, or consume hydrogen and emit only water. Because when it comes to thinking green, the sky's the limit.
*Estimated savings compares each U.S. hybrid vehicle's EPA combined mpg rating with its segment average based on latest EPA Trends Report (driven 15,000 miles annually). Actual mileage will vary. ©2009

fines its losses to the building's price decline—say, a 10% hit if the value falls 10%. Property owners that used debt to finance their purchases experience a greater loss.

The company, which bought properties on the cheap after the savings and loan crisis in the 1990s, also has a well-worn playbook for dealing with distressed properties. When it forecloses on a borrower, GE moves quickly to salvage the existing value from the property. It may renovate, update the amenities, or use local connections to drum up new occupants. "We take over assets ... and run them like a factory," Ronald R. Pressman, CEO of GE Capital Real Estate, said in a conference call with analysts this year.

GE is also redeploying its real estate specialists. Teams in 97 offices across the world, which previously focused on dealmaking, are now managing buildings and reworking loans for troubled borrowers. The company has been working to extend the terms on nearly two-thirds of the debt coming due this year. It allows GE to collect extra fees along the life of the loan while reducing the chances of default.

But such measures will only do so much for GE. The bottom in the commercial market is still a few years away. And the broader economy is unpredictable; if the recession continues longer than expected, a recovery in real estate may be delayed. Says Christopher J. Panos, a lawyer with Craig & Macauley in Boston: "There are a lot of issues in commercial real estate portfolios that just haven't been dealt with." | BW |

FREE FALL

U.S. commercial real estate prices are down 39% from their peak



*U.S. aggregate of all property types
Data: Moody's Investors Service and Real Estate Analytics

A CAUTIONARY TALE AT SUNSTONE

The hotel investor's scramble to rework loans highlights the gridlock adding to commercial real estate's woes

By Christopher Palmeri

When the hotel business was hot, Sunstone Hotel Investors was a ferocious buyer. From 2005 to 2007 the real estate investment trust snapped up $2 billion worth of properties, financing many deals with commercial mortgage-backed securities (CMBS). Now the travel industry is in tatters, and the large Southern California firm is scrambling to renegotiate its payments with lenders, which aren't making it easy. "Someone said that CMBS was a car meant to go forward fast," says Sunstone Chief Executive Officer Arthur L. Buser. "They don't do very well in reverse."

The standoff between borrowers and lenders, like those in the residential market, will only exacerbate the problems in commercial real estate. On Sept. 15 the U.S. Treasury Dept. and the IRS announced rules designed to give bondholders more flexibility to modify loans. But bondholders low down on the food chain still have little incentive to cut deals. If they do, they risk losing their entire stake since their investment is often wiped out first. The result is that negotiations often end in gridlock, or what some in the industry call "delay and pray." When they delay too long, borrowers can end up in foreclosure, which depresses the market further.

Buser has pulled every possible lever to cut the firm's debt, which stood at $1.7 billion at the start of 2009. The firm has sold two small properties: a Marriott hotel in Napa and another in Riverside, Calif., for $36 million and $19 million, respectively. But in this tight credit environment, Sunstone is having trouble finding buyers for other locales that carry higher price tags and mortgages. "Lenders are still not prepared to accept the kind of values that buyers are prepared to offer," says Jim Butler, a real estate attorney at Jeffer Mangels Butler & Marmaro.



Return to lender: Sunstone gave creditors the keys of the W San Diego hotel

CHELSEA LAUREN/GETTY IMAGES

Sunstone has had some luck with creditors. On Sept. 16 it announced an agreement with bondholders who control a $105 million loan on the Renaissance Harborplace Hotel in Baltimore. The creditors are letting Sunstone defer $6 million of payments for 30 months.

Other negotiations have been less successful. The bondholders on the W San Diego hotel and a Marriott in Ontario, Calif., wouldn't budge. So Sunstone simply handed the keys to the lenders. It has stopped making payments on another property, the Renaissance Westchester Hotel.

Still, Buser is optimistic. He's encouraged by an uptick in group bookings at the company's hotels in Orlando and Washington, D.C. "The economy will recover, values will go up," he says. "It's just a question of when." | BW |

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WHY PAYCHECKS COULD SHRINK

High unemployment and low inflation may lead to a decline in pay—and that could slow the recovery

By Peter Coy

Will employers take advantage of the abundance of available labor to cut workers' paychecks? It would be rare for wages to fall economywide, and it's not in most economists' forecasts. Nevertheless, outright declines in average pay are a genuine possibility—and if they were to occur would be a major threat to the nascent recovery.

For now, pay is still rising—a little less than 2% for the year through June 2008, according to the government's employment cost index. But the weak job market is creating the perfect conditions for a decline in pay: low inflation and high unemployment (9.7% in August). With a huge reserve army of unemployed—more than 2 million of them college-educated—it would be easy for many employers to demand concessions.

One of Wall Street's more bearish forecasters, Goldman Sachs chief U.S. economist Jan Hatzius, predicts that average hourly earnings will fall about half a percent from the fourth quarter of 2009 through the fourth quarter of 2010. Hatzius says his prediction accounts for workers' strong aversion to wage cuts. Without that adjustment, the projection would be negative 2%.



TIM SUMMERS

Some economists argue that falling pay would help cure unemployment: Companies would hire more people if they didn't have to pay so much for them. But others warn that wage cuts would make it harder for workers to repay their debts.

The risk is a downward debt-deflation spiral like those of the U.S. in the 1930s and Japan in the 1990s. In such a trend, debt-burdened workers cut back on spending to make their interest payments, which drags the economy down even more. "Imagine a person who got laid off six months ago," says Paul Ashworth, senior U.S. economist for consultants Capital Economics. "They're going to get more and more desperate to get a job and more and more willing to take lower wages as time goes on." While wage deflation isn't Ashworth's "central scenario," he says it's dangerous enough to bear watching.

In the short run, workers could come out O.K. if prices fall even faster than their salaries. Late last year, for example, Americans got a big boost to inflation-adjusted pay because of the huge drop in gasoline prices. But since the start of 2009, inflation-adjusted wages have been roughly flat. Average hourly earnings for production and nonsupervisory workers, or 80% of the workforce, have fallen fractionally after adjusting for inflation.

PAY RECOVERY IN 2010?

Slightly better was the seasonally adjusted employment cost index of wages and salaries, which covers all civilian workers. It was up about 1% from the end of 2008 after adjusting for inflation. The index for professionals and managers was up a little less. In any case, falling prices are no cure-all in the long run. Deflation caused by excess capacity is destructive and hard to stop, as the Japanese have discovered.

The conventional wisdom is that 2010 will be a year of recovery for pay. Benefits consultants Towers Perrin and Watson Wyatt Worldwide conducted employer surveys earlier this year showing a median forecast of 3% increases in base pay next year. Next year "will certainly be improved," says Laura Sejen, Watson Wyatt's global practice director for strategic rewards.

Will wages really recover, though? Federal Reserve rate setters on Sept. 23 pointed to "substantial resource slack" in the economy. Labor is the economy's single most important resource. As unemployment keeps rising, downward pressure on wages will get stronger—and that could mean tough times all around. |BW|

LABOR EARNINGS UNDER PRESSURE



Data: Bureau of Labor Statistics *August 2009 Dollars

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BOXED IN AT US AIRWAYS

With few options to raise much-needed cash, the carrier faces a daunting winter



By Dean Foust

Doug Parker, the youthful CEO of US Airways, is accustomed to living on the edge. A financial whiz who cut his teeth as a fare analyst, Parker was named chief executive of America West Airlines 10 days before the 2001 terrorist attacks. Four years later, Parker merged with the twice-bankrupt US Airways, creating a carrier that has since lost about $1.5 billion—and is on pace to lose an additional $565 million in 2009.

With the specter of swine flu and continued economic troubles looming over air travel, some analysts now question whether US Airways can survive the traditionally lean winter months. "They've leveraged everything they own and don't have many other ways to raise cash," says Robert Herbst, an industry consultant and editor of AirlineFinancials.com.

But sitting in a cramped conference room at his airline's Tempe (Ariz.) headquarters, the remarkably relaxed Parker, 47, brushes aside the doomsayers. "I don't see any more casualties this business cycle," he says. With business bookings picking up, "it feels as though we're climbing out of this."

$600 million
US Airways' projected annual loss in 2009
Data: Analyst reports

Still, he's determined to gird the $12.1 billion airline against any further downturn in traffic. A recent increase in luggage fees is expected to generate $400 million in revenue this year. In mid-August, Parker also engineered a creative "slot swap" with Delta Air Lines, through which US Airways gained the ability for fly 42 more daily flights out of Washington's Reagan National Airport in exchange for giving up many of its slots at New York's LaGuardia Airport, where it has a 4% share of that market.

There's only so much Parker can do. For one thing, US Airways has the weakest hub network of any traditional carrier. Despite streamlining its operations in Phoenix, Charlotte, and Philadelphia, those cities generate less revenue than hubs for other carriers. And while larger carriers are stockpiling cash for the coming winter—American Airlines recently secured $2.9 billion in new financing—US Airways' options are more limited. It's sitting on nearly $1.5 billion in cash, a level Parker believes is sufficient to ride out the winter, but the company's restrictive loan covenants limit his ability to spend the money as he might like.

On Sept. 22, US Airways announced that it would sell 26.3 million new shares to Citigroup. That will raise just a little more than $100 million, but with shares trading below 5, Parker probably couldn't have sold much more without incurring the ire of shareholders. "We certainly don't like diluting our shareholders," he says, "but in times like this, more liquidity is better than less."

CEO Parker boosted fees for checked bags and is issuing new stock to Citigroup

How much more Parker can do isn't clear. The airline's chief financial officer, Derek Kerr, estimates that the carrier could raise $150 million more by borrowing against some training centers and repair hangars.

Despite the challenges, a number of industry watchers aren't ready to count out Parker, who is considered one of the best financial minds in the business. "If Doug went to Wall Street to raise capital for a new airline, he'd have $1 billion in commitments before he got to the end of his [PowerPoint] deck," says Robert W. Mann, an airline industry consultant in Port Washington, N.Y. The problem, though, is with the airline he's got. With few resources and a cloudy outlook, Parker may be facing a winter of discontent. |BW|

BLAIR BUNTING



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FILL 'ER UP–WITH HYDROGEN

Automakers, energy companies, and even Germany's government are seeing new potential in fuel cells

By Jack Ewing



FRANKFURT

No self-respecting automaker would have dared appear without a zippy-looking plug-in prototype at September's Frankfurt Auto Show. So amid all the hype about electric cars, it was a surprise to hear Daimler CEO Dieter Zetsche declare that hydrogen fuel cells, not batteries, are the ultimate way to move beyond oil. "The chances further down the road seem to me better on the fuel-cell side than on the battery-electric side," Zetsche told reporters at the show on Sept. 15. Hydrogen, he said, beats batteries at moving cars long distances without refueling. Fuel cells can also power big, roomy sedans much more readily than batteries can.

Fuel cells, which separate electrons out of hydrogen atoms to create electricity, were much hyped early in the decade. But they were soon upstaged by hybrids and battery-powered electrics. Yet on Sept. 10 the German government, along with Daimler and a group of energy companies including Royal Dutch Shell, announced plans to build 1,000 hydrogen filling stations in Germany by 2015. Two days earlier, Toyota, Ford, General Motors, Hyundai, and others called on energy companies to create a global network of hydrogen filling stations. By 2015, carmakers say, there could be hundreds of thousands of fuel-cell vehicles on the road.

Electric cars will probably be commercially available before hydrogen models, and they certainly enjoy higher public awareness. But little-noticed advances have helped hydrogen regain credibility with carmakers. Daimler, Honda, and others have reduced the size of hydrogen fuel-cell systems to the point that they fit into a midsize sedan. Honda is testing 35 FCX Clarity fuel-cell cars on Japanese and U.S. roads. Daimler's prototype, a hydrogen-powered Mercedes B-Class compact, can travel 240 miles before refueling, which takes three minutes. By contrast, battery-powered test versions of BMW's Mini can travel a little over 100 miles before they need a three-hour recharging.

The ideal combination may be a hydrogen hybrid that runs on a battery for shorter trips while drawing on the fuel cell for longer jaunts. The technologies complement each other, since both use electric motors to drive the wheels and require sophisticated software to work.

Government funds also help. Germany is expected to cover half the $2.6 billion cost of creating a hydrogen fueling network. In addition, the cost of generating an hour of electricity with a hydrogen fuel cell has fallen more than 20% since 2007, to $78. A drop to $30 is possible by 2015, which would make hydrogen competitive with gasoline.

A CLEANER CHOICE

POWER SOURCE	CO_2 EMISSIONS (GRAMS PER MILE)
Gasoline	410
Gasoline hybrid	250
Hydrogen from natural gas	210
Hydrogen from water	<45

Projections based on state of technology in 2020. Data: U.S. Energy Dept.

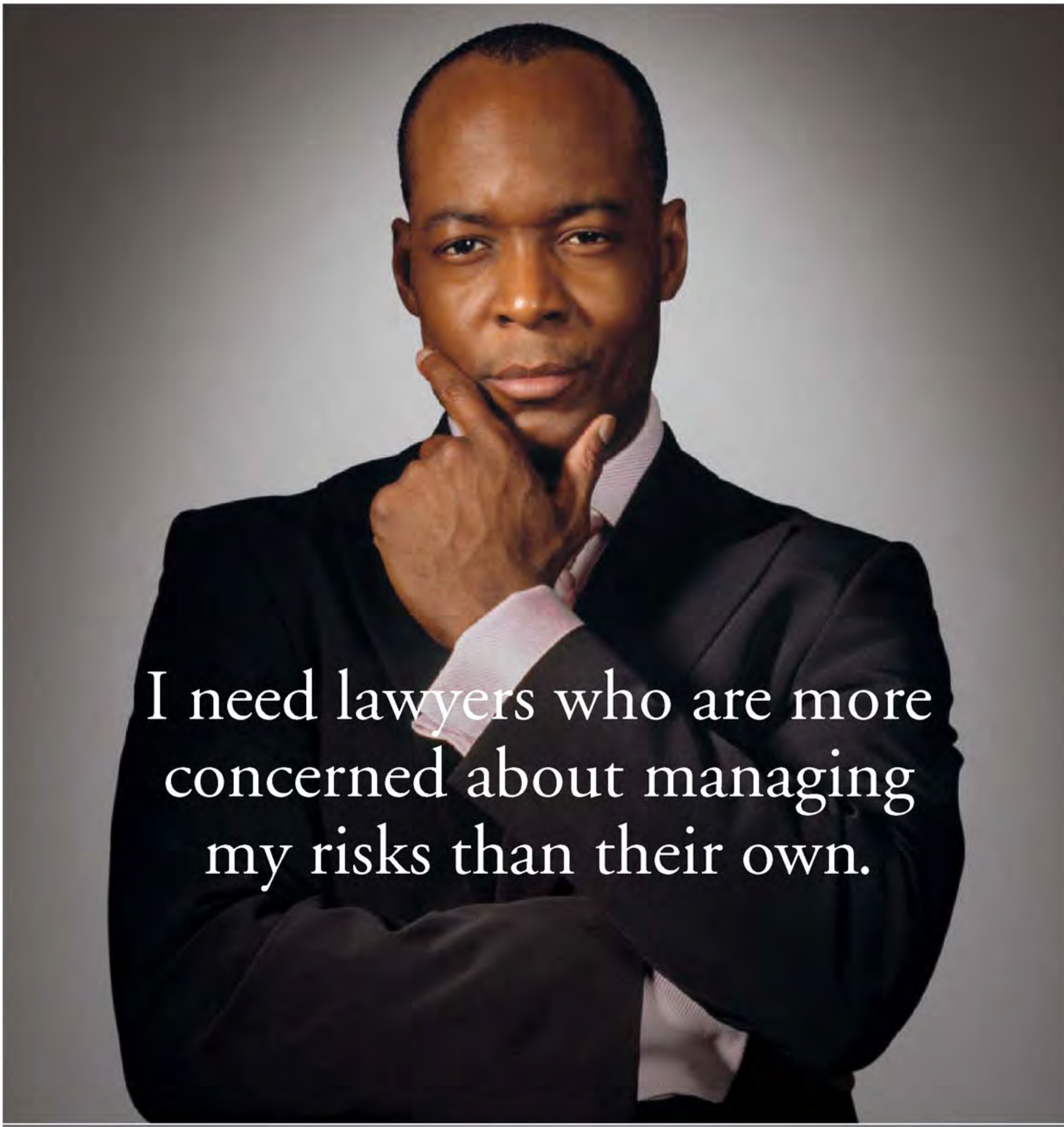
ONGOING INVESTMENT

Plenty of people still doubt that fuel cells are practical. "Explain to me where the energy comes from to produce the hydrogen," says Rupert Stadler, CEO of Volkswagen's Audi unit. The central problem is to produce hydrogen in a way that doesn't cancel out the environmental gains. Most hydrogen available today is refined from natural gas. Deployed in a fuel-cell car, such hydrogen would generate 16% less CO_2 than a hybrid engine – significant, but hardly revolutionary. That's why U.S. automakers put more emphasis on battery-powered vehicles such as GM's Volt, though that car needs a gasoline engine for longer trips.

But carmakers continue to invest in hydrogen, since they fear batteries will be practical only for short-range vehicles. "Although batteries are evolving, I don't think they can catch up with fuel cells," says Honda CEO Takanobu Ito. So what technology do you pick? Both. To ignore either one, Zetsche warns, "would be extremely risky." |BW|

–With Ian Rowley in Tokyo

KYLE T. WEBSTER



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THE FOURTH IN A **SERIES OF 4 >**

PUTTING THE NETWORK SECURITY PIECES TOGETHER



AS PREVIOUS articles in this series have explained, corporate IT networks have long been under assault from outside forces.

In recent years, however, these threats have become more sophisticated than ever before. No longer focused merely on hacking or denial-of-service, cyber-criminals now aggressively strike at the heart of corporate value, seeking to steal vital financial and other proprietary information that they can sell on the black market.

Unfortunately, traditional security solutions are simply not up to the task since hackers have taken to the cloud to propagate their attacks and stealing information, but Trend Micro has been pioneering security utilizing the cloud to thwart these attacks.

A REVOLUTIONARY IT SECURITY MODEL

Enter Trend Micro's™ "Smart Protection Network™"—one of the most revolutionary IT security infrastructures ever created. Built around a next-generation, cloud-centric architecture, the Smart Protection Network is designed to block malware threats *before* they have the opportunity to infiltrate IT networks. And if data-sharing malware already has intruded, the Smart Protection Network prevents compromised data from being sent back out to malicious servers.

Among the cornerstones of the Smart Protection Network are a suite of "reputation technologies" that ensure that only legitimate, or "reputable," data are being passed into and out of the corporate network. These technologies include: (1) web reputation technology, which analyzes and halts malicious web traffic by monitoring URL changes and other suspicious behavior; (2) email reputation technology, which stops email-based threats by validating IP addresses against a large and dynamic database of email sources; and (3) file reputation technology, which frees endpoint resources by moving pattern files to the cloud.

CORRELATION TECHNOLOGY AND BEHAVIOR ANALYSIS

As powerful as these technologies are individually, it is how they work together that gives the Trend Micro Smart Protection Network its greatest strength—its ability, not possessed by most conventional security solutions, to thwart "disaggregated" assaults. In times past, most IT threats were self-contained—a single virus, a single hacking attempt, and so on. Now, cyber-criminals are able to create malicious software that trickles into a network in tiny, seemingly harmless code blocs that reassemble once inside the network in order to wreak their damage.

Because of their perceived innocence, these code blocs can escape detection even by threat monitors with robust, information-rich databases. But the Trend Micro Smart Protection Network uses correlation technology and behavioral analysis to identify and halt the attacks. Correlation technology, for instance, examines relationships among the different elements of a "quiet assault" in order to create a holistic and coherent picture of its potential dangers. In so doing, the system can determine in real-time whether putatively harmless components do indeed constitute an emergent threat—in time to act before that threat actually materializes.

The Smart Protection Network also uses behavior analysis to correlate activities within a single session on the same protocol, as well as activities that occur during multiple network sessions on a common protocol. Activities of multiple sessions and different protocols are also correlated in order to identify suspicious combinations of activities, such as an email containing an apparently harmless URL link that is nevertheless connected to a web page hosting a malicious downloadable file.

A BATTLE-TESTED SOLUTION

Of course, the Trend Micro Smart Protection Network, which powers most of Trend Micro's solutions, would be of little value if it were mere theory. But it is in its battle-tested deployment on thousands of IT networks that this revolutionary new security strategy has proven its real mettle. The numbers speak for themselves: each day, Trend Micro blocks and neutralizes 1 billion malicious threats accessed by its customers. That's a record of accomplishment that should appeal to any corporate IT manager concerned about the modern and increasingly malevolent security threats that continue to rise up all around them. ◆


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Lakeridge Health Taps Trend Micro, Reduces Security Management Costs 10-15%
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Georgia-Pacific LLC touts Trend Micro: "Right Functionality & Good Value"
page 3C
CUT COSTS UP TO 40%.*
Think better protection has to cost more?
THINK AGAIN.
*A recent, independent research study shows that Trend Micro™ Enterprise Security, powered by the Trend Micro Smart Protection Network,™ can lower your management costs by up to 40%. That's because this next-generation, cloud-client security infrastructure enables a unique combination of solutions and services to stop threats before they reach your network, significantly reducing enterprise risk and productivity loss. Enterprises around the world are saving big and you can too. Run the numbers and see how the Trend Micro Smart Protection Network can help you reduce costs without compromising security.
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THE STOCK MARKET

SEARCHING FOR TRUE NORTH

By Roben Farzad
with Tara Kalwarski
Photograph by
Christopher Anderson

Investing gauges are broken, market signals are mixed, and money managers don't know where to turn. What exactly is the "new normal"?

Well-intentioned people can disagree over the Great Recession's place in history. In one important sense, though, the chaos of the past 18 months has been unprecedented. It has shattered deeply held beliefs about the basic functioning of the stock and bond markets and left the best minds in finance—to say nothing of ordinary people—grasping for explanations. ¶ The sacred texts of investing need to be rewritten. It turns out that the so-called equity risk premium, the once-sacrosanct belief that stocks perform better than bonds over time, has been vastly overrated. Earlier this year, according to the Leuthold Group, a Minneapolis research firm, U.S. Treasury bonds had outperformed U.S. stocks over the preceding 10- and 20-year periods. And that was only the beginning. Bonds also beat stocks over the past 30 years. Even the 40-year returns were basically equal, a feat never before witnessed in the U.S. markets. Over other periods, of course, stocks performed far better. But for four decades they were a sucker's bet.

If the bedrock principle of investing—that shareholders are compensated over the long term for the risk of buying equities—is a fallacy, then what, if anything, can investors believe in? Which assumptions can be trusted? What is "normal"? During the panic the markets were "way out of whack," says John H. Cochrane, a finance professor at the University of Chicago's Booth School of Business and vice-president of the American Finance Assn. "I don't know what's going to happen to the stock market next. And I have a highly educated view that no one today really knows."

Amid this cosmic confusion, two opposing theories are emerging. One group of prognosticators claims the markets are in the throes of a "new normal," a long period of slow growth during which old investing rules will give way to new ones. The other group says the epic abnormality of the past few years will soon be swept away by a massive reversion to historical patterns. Depending on whom you believe, today's stock market is either a trap door or a coiled spring.

HOW TO PLAY IT 075

Caught in the middle are thousands of professional investors searching for the market's true north. They don't have much time to fumble around: Their livelihoods depend on people believing that they know what they're doing. Managers of mutual and hedge funds are struggling to figure out not only how to make their customers money but also how to justify their fees. Financial advisers

MAGNUM

"INTEREST RATES ARE ZERO ... AND YET THE ECONOMY EXACTLY IS THE STOCK MARKET ROMANCING?"





"EVERYBODY WANTS TO FIND SOMETHING IN THE PAST SEE ANYTHING. I CAN ONLY MONITOR THE PRESENT"

are rethinking outdated formulas of "asset allocation" as clients demand more safety. Pension fund managers face the politically dicey task of rebuilding their portfolios without taking on excessive risk or demanding bigger contributions. All are yearning for signals of how the future will play out.

STARVED FOR CAPITAL

The executives at Pacific Investment Management, or PIMCO, say they have the answer. The bond fund giant has adopted the phrase "new normal" to describe the changes taking place. "If you are a child of the bull market, it's time to grow up and become a chastened adult," writes William H. Gross, manager of PIMCO Total Return, the world's largest bond fund, in his September dispatch to investors. "It's time to recognize that things have changed and that they will continue to change for the next—yes, the next 10 years and maybe even the next 20."

PIMCO cautions stock investors to accept lower returns long into the future. In the new normal, says PIMCO, economic growth will continue to be slow and unemployment high as the U.S. loses clout to China and the rest of the emerging economies.

PIMCO CEO Mohamed A. El-Erian, a 15-year veteran of the International Monetary Fund who later managed Harvard University's endowment, contends that the economic crisis will run so deep that it will vanquish all assumptions about stock market valuations. As the economy's growth rate resets lower, he says, a broad swath of companies will find themselves starved for capital. The easiest, and increasingly only, way for them to recapitalize will be to issue more equity, "diluting" or even wiping out shareholders' assets. "That reality," El-Erian says, "is not captured in the equity risk premium model and what people assumed was normal. Stock prices will come to reflect this threat permanently."

PIMCO is in the belly of the recession beast. Its Newport Beach (Calif.) headquarters are in Orange County, aka Subprime U.S.A., home to cookie-cutter subdivisions populated and then vacated during the real estate boom and bust. The county famously went bankrupt in 1994 but collected itself enough to chase ruin anew a decade later. An eerie quiet pervades the place. Along the freeway, defunct mortgage start-ups have shrouded or dismantled their billboards.

Whatever just happened in the markets has been unmistakably good for PIMCO. The firm has taken in $120 billion of fresh assets since the start of 2008. Since its 1971 founding, PIMCO has increased its assets from $12 million to $842 billion, $180 billion of which is concentrated in PIMCO Total Return. That portfolio has returned an average of 6.34% over the past five years, well north of its 5.14% benchmark and the 2.25% loss posted by the Standard & Poor's 500-stock index.

El-Erian, who is also PIMCO's co-chief investment officer, is highly skeptical of the stock market's recent rally. "Interest rates are at zero, there's $2 trillion plus on the Federal Reserve's balance sheet, and yet the economy is still losing jobs," he says. "What exactly is the stock market romancing?" According to PIMCO's new normal, equities should make up just 30% to 54% of a portfolio, with no more than half in the U.S.—much less than the traditional 60% commitment to stocks and 40% to bonds.

Of course, PIMCO, a bond shop, has an incentive to paint stocks as less attractive. But other asset managers are sounding a similar theme. One is Robert Arnott, chairman and founder of Research Affiliates, a research and analytics firm also based in Newport Beach whose strategies guide $43 billion in institutional investments. "Most investors hold portfolios that rely too much on a sizable equity risk premium," he says. "With 50% or 60% invested in stocks, equity declines can overwhelm bond returns."

Arnott's research, published in a March note to clients,

(L TO R) TIM RUE/CORBIS; MICHAEL NEMETH/WONDERFUL MACHINE; CHART BY ALBERTO MENA/BW

IS STILL LOSING MONEY. WHAT

MOHAMED EL-ERIAN



THAT LOOKED LIKE THIS. I DON'T

RONALD H. MUHLENKAMP

finds that the standard 60/40 stock/bond mix had almost a one-to-one correlation with the S&P 500. In other words, the Treasury bonds in that hypothetical portfolio would provide no diversification. The new normal of asset allocation, Arnott posits, calls for radical diversification into inflation-protected Treasuries, commodities, and other assets less correlated with stocks.

OLD NORMALISTS

At the other end of the philosophical spectrum are what one might call the "old normalists"—people who believe the stage is set for a dramatic return to traditional patterns. "The new normal," says Kent Engelke, chief economic strategist at Capitol Securities Management in Richmond, Va., "is really just the old normal reverting back to the [long-term] mean."

Between 1900 and 1999, old normalists point out, stocks gained 12.9% a year, vs. 4.7% a year for bonds—no small spread. "Market history says returns for stocks and bonds will reverse to a normal state, where risk is appropriately rewarded with higher returns," says Eric C. Bjorgen, senior analyst at Leuthold Group. So striking is the apparent disconnect that Leuthold in June sent clients a 35-page report titled "Exploiting Generational Anomalies in Stock vs. Bond Returns."

Investors are having trouble making sense of the debate over normalcy. Far away from Newport Beach, in the steel country of Wexford, Pa., lives Ronald H. Muhlenkamp, a veteran fund manager and founder of Muhlenkamp & Co. "I don't know what the new normal is," says Muhlenkamp. "Everybody wants to find something in the past that looked like this. I don't see anything. I can only monitor the present."

Muhlenkamp, 65, has just suffered three of his worst years since launching the fund in 1988. In 2008's growler of a bear market, he posted a 40% loss. Despite a 32% gain thus far in 2009, Muhlenkamp lags the S&P 500's three-year annualized loss of 4.5% by three points. "For money managers," he says, "what worked in the past 40 years did not work in the past two."

Muhlenkamp is in that nether region between studying the past and getting stuck in it. Normalcy, he argues, is in the eye of the beholder. "My granddad was lame because a rooster pecked him in the knee," Muhlenkamp says. "That was his normal. He'd never dream he could have three-minute arthroscopic surgery today."

Muhlenkamp isn't alone in his consternation. All manner of so-called active managers are reeling from their worst year on record and trying to prove their worth in an era of low-cost index funds. Even sophisticated hedge funds, which were designed to hedge, or protect, against 2008-style catastrophes, fell 18% on average last year. The drubbing was not only an embarrassment for high-fee funds promising "absolute returns" but also shocking in that the results were just two points better than the loss posted by a plain-vanilla 60/40 stock/bond allocation using inexpensive index funds.

Given the market's violent swings of late, the task before active managers will likely get harder before it gets easier. Has investing ever been more confusing than in 2009? First the Dow Jones industrial average lurched toward 6500, a level that, adjusted for inflation, hadn't been seen since 1966 (chart). Next it surged 52% even as unemployment headed toward double digits. "We've never had a six-month period where we've lost 2 million jobs and the market has gained 50%," says Barry L. Ritholz, noted economics blogger and CEO of FusionIQ, a quantitative research firm. "That's simply unprecedented."

Muhlenkamp is working hard to rebuild his asset base,



*Using August 2009 as the base
Data: Bloomberg, Bureau of Labor Statistics, *BusinessWeek*

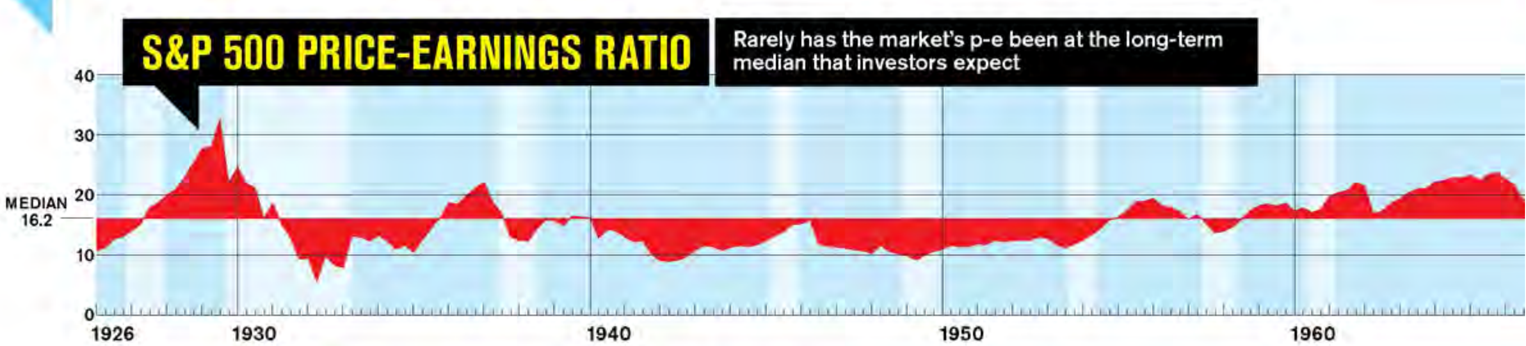
which despite a 40% rise in 2009 has plummeted from $3 billion in 2006 to around $900 million today. Last September, amid Wall Street's meltdown, Muhlenkamp went 30% into cash, his highest allocation in 10 years, and in January he bought bonds for the first time since 1983. He did, in other words, everything the textbooks suggested would avert disaster—to no avail. "It wasn't enough to save us," he says. "I let a lot of people down." In March, he says, one 20-year client called to sell out, only to phone again in August to get back in, after having missed out on a 50% gain.

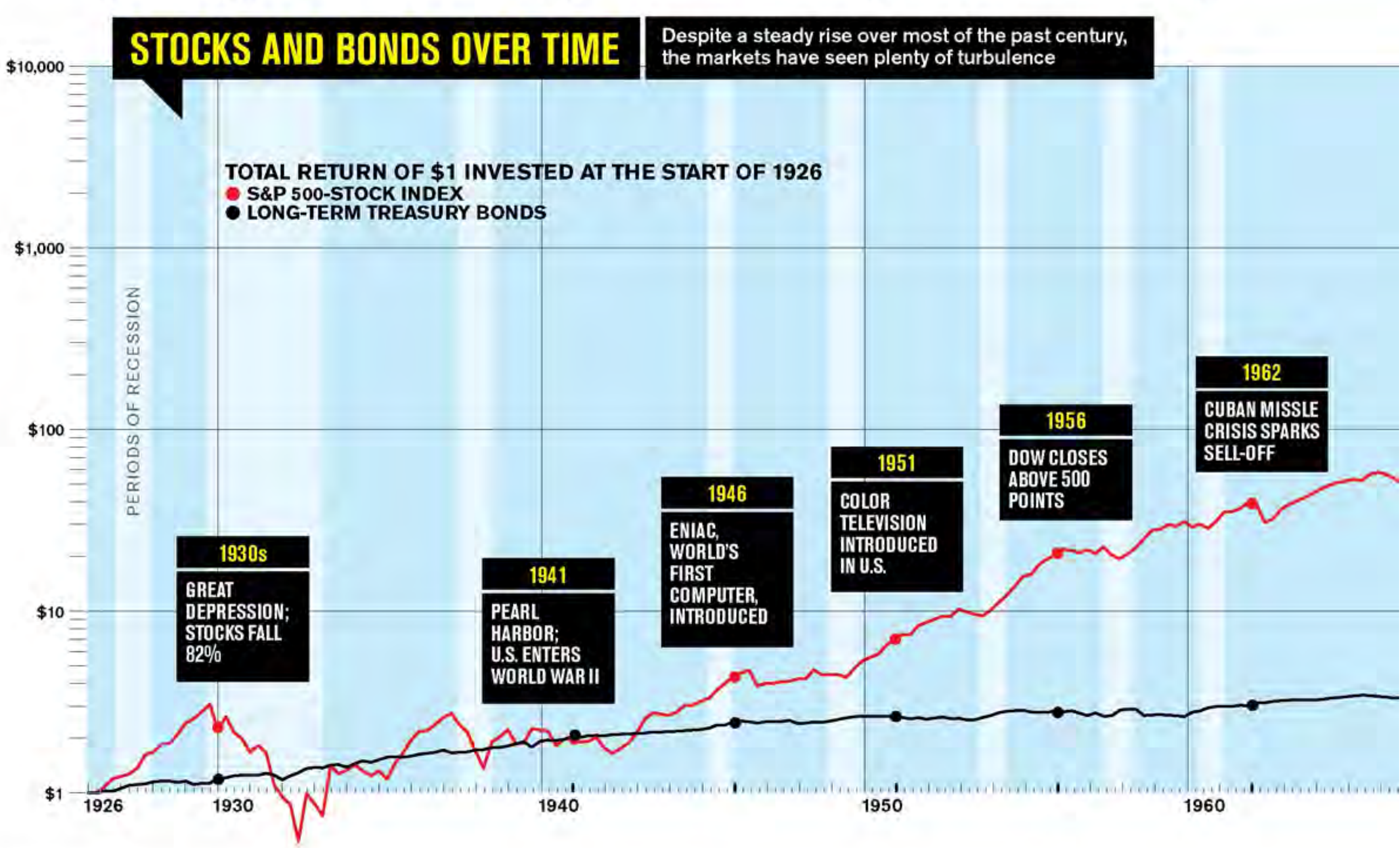
The notion of "normal" is especially vexing for financial advisers and planners, the professional asset allocators who help structure portfolios for retail investors. For them, decisions about how to spread money around have never been more difficult—at a time when customers have never been so skittish. Some advisers, fed up with the old models, are charting a new course.

Jerry Goss has run money for clients out of Baton Rouge, La., for 29 years, 27 of them for A.G. Edwards, the Midwestern brokerage whose roots date to 1887. Wachovia acquired A.G. Edwards in 2007, one year before Wells Fargo swooped in to take over Wachovia during the financial panic. Says Goss, 60: "2008 was the second-worst year of my life." (In 1992, Goss was diagnosed with non-Hodgkins lymphoma and endured

CHART BY ALBERTO MENA/BW

WHEN WAS THE MARKET EVER NORMAL?





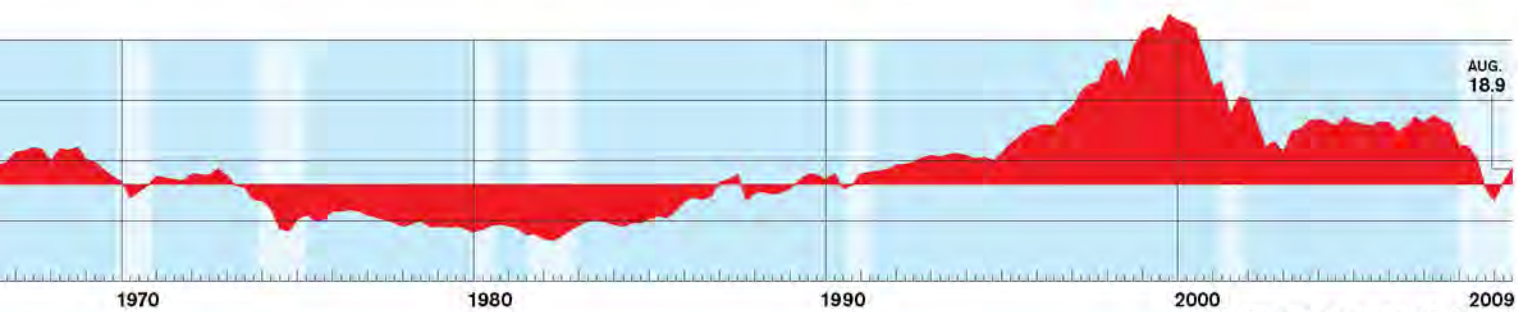
nine months of chemotherapy.) "It's one thing to have clients call you about their portfolio losses. It's another to have to defend your bank as it blows up."

Goss for decades put his clients' money in mutual funds, including some run by American Funds and First Eagle, buying-and-holding his way to double-digit annual returns. That success ground to a halt this decade, culminating in an average 30% drop in stock holdings last year. "I did a lot of soul-searching," says Goss. "The market we have today is vastly different from anything I've seen in my career."

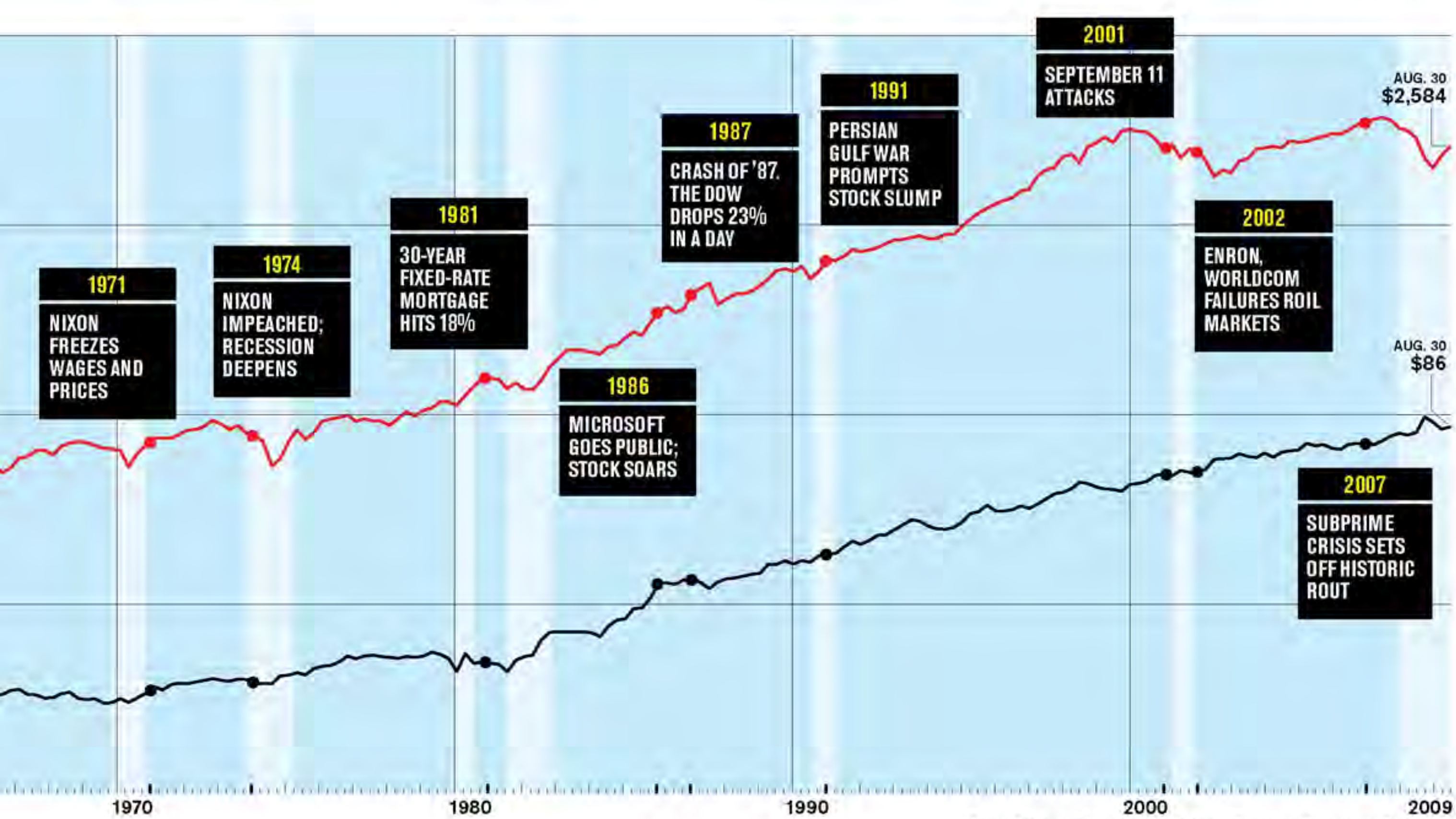
Goss resents how the mutual funds in which he put customers' money failed to act as the markets tanked. Instead of being tactical and moving aggressively out of stocks and into cash, he says, his funds stuck to antiquated models of asset allocation, failing to appreciate the damage a 30% equity loss can do to a small investor's portfolio. (After suffering a 30% loss, an investor would need to gain 43% to break even.)

As the market plunged to its March low, Goss reinvented his investment approach. Now buy-and-hold is out, and "tactical asset management"—moving money to the sidelines when conditions warrant—is in. Goss liquidated his clients' mutual fund holdings in March and kept as much as 40% of the proceeds in cash. He then plowed that cash into commodities and international exchange-traded funds, the two sectors

Over the past eight decades, the stock and bond markets have been much less predictable than the models suggested.



Data: Robert Shiller, *Irrational Exuberance*



Data: Ibbotson Associates, National Bureau of Economic Research



BRADY FONTENOT

NOWADAYS NOTHING IS "AS IMPORTANT AS PROTECTING ON THE DOWNSIDE" JERRY GOSS

that have flashed brightest in relative strength since March, according to Richmond-based research house Dorsey Wright & Associates. Yet for all his toil, Goss has trailed the S&P by a hair since he launched the strategy in March. While outperforming the benchmark would be nice, he says, it's "no longer as important as protecting on the downside. It's now all about not losing money."

MISSING A STOCK RALLY

Managers of elite public pension funds are just as confused as private money managers about how to invest, and they have an added dimension of ugliness to deal with: politics. According to Boston College's Center for Retirement Research, state and local pension plans, many of which have assumed 8% annualized returns, are running at least $1.2 trillion short of their target. To be fully funded, they'll have to see contributions rise sharply—no easy sell to taxpayers in this era of gaping deficits.

Pension funds got into this mess in part because they've adhered to outdated investing approaches. The Great Moderation, a theory that rose to prominence in the late 1990s, held that economic cycles would be longer and milder than in the past and that investors could therefore feel comfortable investing in higher-yielding but illiquid, or difficult-to-sell, assets. Amid the panic of 2008 the values of some of those assets crashed, devastating many a pension fund portfolio. Worse, because illiquid assets can't be unloaded quickly, funds have had less flexibility to dive back into the rallying stock market. As a result, some of the largest, savviest, and most influential pension funds in the world are lagging common stock market benchmarks—and are beginning to draw the ire of state and local politicians.

In Florida, the State Board of Administration, which oversees $110 billion in pension assets, had a 12.5% gain in the second quarter, short of the S&P 500's 15.2% rise. Why the underperformance? The fund had reduced its stock holdings to invest in illiquid assets, thereby missing the chance to capitalize fully on the recent once-in-a-lifetime stock market rally. "Certain asset classes and subclasses lagged," acknowledges SBA executive director Ashbel C. "Ash" Williams.

The California Public Employees' Retirement System (CalPERS), the nation's largest pension fund, is in a political dogfight. Its asset value in 2008 plunged a record 23.4%, worse than the performance of a basic 60/40 stock/bond portfolio. The $56.2 billion loss wiped out six years of earnings for CalPERS' 1.6 million working and retired clients, according to Bloomberg. "We're still negotiating what's happening in the markets," says a CalPERS spokesman. "Like everyone else, we don't have a crystal ball."

Far from it. According to internal documents reviewed by *BusinessWeek*, CalPERS in 1999 was assuming it would generate annual returns of 8.25% over the following decade. Since then the fund has posted an average annual gain of just 3.25% and has lowered its return assumption to 7.75%.

In July, CalPERS reckoned that it could close its funding gap over the next 15 years if it were to post annual returns of more than 8% and if state contributions were to grow by more than 4%. Given the fund's recent track record, those results seem highly optimistic. Amid the sharpest stock market rally in decades, CalPERS has cut its stock holdings from 56% to 49% and plans to devote much of its proceeds to illiquid investments.

Taxpayers, naturally, won't be keen on contributing more. Governor Arnold Schwarzenegger has already demanded reduced benefits for new hires. "CalPERS has for a long time been assuming fantastical investment returns it could never reach," says David Crane, special adviser to the governor for jobs and economic growth. "In turn, the state made pension promises it couldn't keep." The backlash has been so strong that one municipality, Pacific Grove, near Monterey, is looking into ditching CalPERS altogether and replacing it with a 401(k)-style system.

But would a private 401(k) really be better for Pacific Grove's employees than mighty CalPERS? Sure, as long as those investors figure out how to fine-tune their portfolios perfectly for the new normal. Or the old normal. Or whatever. Good luck with that. |BW|

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The true comfort of this furniture comes from knowing what's inside it: a new kind of foam created in part from renewable resources. Manufacturers of foam for the furniture and bedding industries wanted to use less petroleum-based ingredients in their products and asked Cargill for help. Using soybean oil and chemistry, we developed BiOH™ polyols, a new foam-making ingredient. The resulting product performs like traditional foam, yet consumes less petroleum. Several national brands are now using it in their furniture—making homes more inviting for both people and nature. This is how Cargill works with customers.

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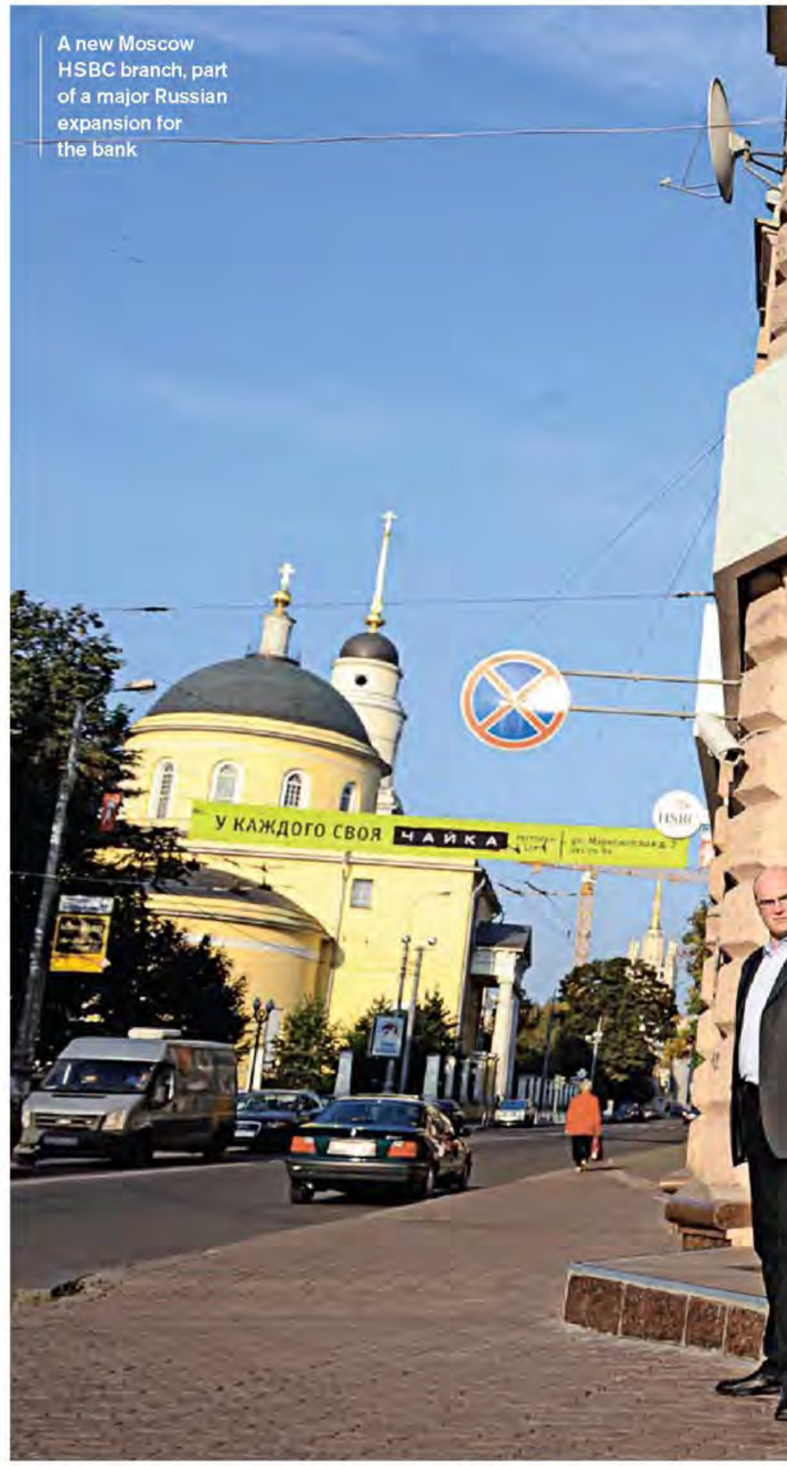
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COUNTRY REPORT

THE PERIL AND PROMISE OF INVESTING IN RUSSIA

By Carol Matlack | Photography by James Hill

It's still risky, but for global corporations, the country is simply too big—and too rich—to ignore



A new Moscow HSBC branch, part of a major Russian expansion for the bank

Why would anyone invest in Russia? The economy is expected to shrink 8.5% this year, and will be slow to recover its momentum. Inflation is in the double digits. Even President Dmitry Medvedev calls corruption in his country "endemic." And sophisticated investors know all the horror stories of operating there: BP locked in headline-grabbing clashes with its joint venture partners. Royal Dutch Shell entangled in endless charges of violating environmental laws. William Browder, a pioneer investor in Russia, mysteriously denied re-entry into the country while his Russian fund is stripped of its assets. Swedish retailer Ikea suddenly blocked by authorities in Samara from opening a huge store it had just built, ostensibly for violating the local building code.

And yet many multinationals—big, battle-scarred companies, veterans of coups in Brazil and hyperinflation in Tur-



key—refuse to pull out of Russia. Instead they're digging in for the long haul. John Deere, Unilever, and HSBC all have begun major Russian expansions in the past few months. Wal-Mart Stores has an advance team on the ground as it mulls opening a Moscow location, following French hypermarkets Carrefour and Auchan. On Sept. 1, Topeka (Kan.)-based Collective Brands announced it would open 90 Payless ShoeSource outlets across the country over the next five years. "Among emerging markets, Russia has moved to the top of our list," says Chief Executive Matthew E. Rubel. Even companies that have been beaten up in Russia, like BP and Ikea, say they'll keep investing.

For major global corporations, Russia is simply too big and too rich to ignore. Abundant reserves of oil, metals, and timber still lure multinationals eager to export those commodities, even though such investments are often fraught with difficulties. But Russia is not just a play for resource companies. Eighteen years after the fall of the Soviet Union, 140 million voracious consumers beckon. Demand for everything from kitchen cabinets to pharmaceuticals is still strong—and Russians have the petrodollars to pay for them. Disposable household income in Russia is 30% higher than Brazil's, almost four times China's, and 10 times that of India (chart).

HOW TO PLAY IT 076

The Kremlin's $280 billion stimulus plan, fueled by oil and gas money salted away in better times, is spurring demand. That's a boon for companies such as Unilever, which reported "strong double digit growth" in Russia during the first half of the year. The Anglo-Dutch company has eight factories in

Russia and recently broke ground for a new $140 million ice cream plant and distribution center in Tula, 120 miles south of Moscow.

Russia's Soviet tradition of education—superb in math and the hard sciences, excellent in languages—still produces plenty of brainy workers. About 20% of working-age Russians have university degrees, not far below the European Union average of 24%. While Russian salaries had been rising sharply before the crisis, they've now flattened out, and multinationals can still find workers for a fraction of the cost in the West.

Consider IT giant Intel, which moved into Russia in 1999 and since then has invested $800 million. It now employs more than 1,000 engineers at four research centers, including its largest software research and development group outside the U.S. Because of Russia's top-notch math skills, Intel assigns local engineers more complex work than it gives specialists in other outsourcing venues such as India, says Dmitry Konash, the company's Moscow-based regional director. The cost of all this mind-bending work? As little as $1,000 a month for a new engineering grad.

LOCATION, LOCATION

Intel also benefits from the hunger newly middle-class Russians display for all sorts of high-tech gear—they want their laptops and PDAs just like the rest of us. Here, Intel has room to run: Only 20% of Russians own a computer, about one-fourth the rate in the U.S. and Western Europe. "Big multinational IT companies accepted a long time ago that they need to be here," Konash says in an interview at his office in a gleaming suburban Moscow office park. Intel's neighbors at the park include Microsoft and Cisco Systems. Hewlett-Packard and Sun Microsystems also have major Russian operations.

The companies that succeed in this alluring but hostile environment follow strict rules of engagement. One key lesson: As in real estate, location is all-important. While corruption and red tape hobble business in much of Russia, some city and regional authorities are beginning to tackle the problems. Even high-ranking officials acknowledge the difficulties. Sitting in an austere, high-ceilinged Kremlin office once occupied by Communist leader Leonid Brezhnev, presidential economic adviser Arkady Dvorkovich offers frank advice. "Investors should choose carefully" among the country's regions, he says, warning that the situation in some areas probably won't improve until old-style governors and mayors have left office. "The best way to make the preliminary judgment," Dvorkovich says, "is to see where other investors have been coming."

A prime example, cited by Dvorkovich and many businesspeople, is the Leningrad region—an area about the size of Maine that surrounds St. Petersburg. The region has attracted $300 million to $500 million annually in foreign investment in recent years, including a Ford Motor assembly plant and a Kraft Foods instant-coffee factory. Local authorities have offered tax breaks and streamlined bureaucratic procedures to pull in such investments. Other up-and-coming areas include Krasnodar, home of the Black Sea resort of Sochi (site of the 2014 Winter Olympics), and the Kaluga region southwest of Moscow, which has attracted manufacturers such as Volkswagen, Nestlé, and Samsung. In contrast, the area around Vladivostok, in Russia's Far East—despite its strategically attractive proximity to China, Japan, and the western U.S.—has drawn little foreign investment. A reputation for corruption clings to the city, cemented in part by the arrests of two former mayors of Vladivostok on charges of abusing the office for personal gain.

Investors have also learned, to their regret, the cost of teaming up with Russian companies. Costly conflicts seem inevitable. "I haven't heard of any joint venture working well. You need 100% control," says Jostein Davidsen, head of Russian operations for Nycomed, a Swiss pharmaceutical manufacturer that recently announced plans to build an $84 million plant in western Russia. The catch is that in some industries the Kremlin deems "strategic," including oil, gas, telecoms, and aerospace, investors don't have a choice. The Kremlin allows participation only through joint ventures or minority stakes in these Rus-

WEAKEST BRIC?

The global crisis hit Russia harder than the other BRIC nations (Brazil, India, and China). But Russians are more affluent.



Data: Russian Government, International Monetary Fund

ANNUAL DISPOSABLE HOUSEHOLD INCOME 2008



Data: Euromonitor

FOREIGN DIRECT INVESTMENT

In billions of dollars, first half of 2009

Brazil	Russia	India	China
12.6	6.1	13.2	43

Data: U.N., national statistics agencies, Nomura Global Economics

CHARTS BY DAVID FOSTER





My warmest greetings to the staff and management of Expocentre, the Exhibition Professionals of the Russian Federation, on the occasion of the Company's 50th Birthday! Expocentre's history came hand in hand with the history of our Country: its centrally planned past and the free market present. It started the Exhibitions and Conventions Industry here and is keeping up the banner of the leader still. It made Russian Exhibition Industry fully conversant with the high international standards well integrated into the global scene.

Expocentre's Trade Shows draw enthusiastic participation from across the international community of exhibitors around the world. Current economic downfall has been a good test for that connection.

Expocentre is at the front edge of technological innovation in Russia setting the tone for the exhibition business of the Country. There is an impressive array of hi-tech shows in its portfolio highlighting the latest achievements in Russia and around the world, helping Russia achieve higher levels of efficiency through technological improvement in respective Economic Sectors: Svyaz-Expocomm, Photonics, High Technologies of the 21st Century, Metalloobrabotka, Elektro, etc.

Expocentre's Team deserves every acclaim and recognition for all that. Happy birthday!

Yevgeny Primakov
President
Chamber of Commerce and Industry
of the Russian Federation



This year Expocentre celebrates its 50th anniversary. The history of our Company is synonymous of the history of industry it launched and developed in Russia over the decades. For a long time Expocentre has been the Russian Exhibition Industry. As others followed more recently, we are still the front runner and we are proud of it.

We started major trade shows way back many years ago which are still current and relevant. Exhibitors and visitors – Russia, CIS and beyond - are still treating them as leading events in the sectors they represent.

Our track record of 50 years boasts over 6 000 events of international stature. 19 are famous brands, world renowned. They carry the seal of approval by UFI – the Global Association of Exhibition Industry.

Expocentre's Central Exhibition Complex – our main Fairgrounds – accommodates some 100 international exhibition events per annum. They are attended typically by over a million visitors from relevant professions and business involvement across the wide range of trade and service sectors. Our convention activities produce over 600 events a year.

The economic downfall has been a challenge for us as it is for many around the world. We have done our best to be worthy of our glorious jubilee and maintain the pace of success keeping all our existing projects on track and launching new.

Our team has done Expocentre proud by keeping up the good work in the difficult year of economic stress, giving us every reason to celebrate the 50th birthday.

Happy Expocentre's birthday everyone!

Vladislav Malkevich
Director General
Expocentre

Expocentre is a leader of the Russian exhibition industry:

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- Independent audit of all own exhibitions
- Over 100 participating countries, 30,000 exhibitors and one million visitors annually

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sian companies. Such deals can be troubled: BP was ensnared in lawsuits and hounded by Russian tax and environmental authorities after a falling-out with local partners in its TNK-BP joint venture.

Buying Russian companies outright can be risky, too. One U.S. CEO recalls hastily backing away from a possible Russian acquisition after meeting the company's owner. The Russian company's books were awash in red ink. But the owner, arriving late for a scheduled lunch with the chief executive in London, apologized by explaining that he had been buying a Renoir painting. The affable Russian then chatted during the meal about his ultraluxurious New York apartment. "It was clear that this company was being run for the enrichment of one person," says the American executive, who spoke on condition of anonymity. His company later decided to enter Russia without purchasing a local enterprise.



Russian workers' math skills give them an edge over Indian engineers, says Intel's Konash

JAMES HILL

CULTURE OF CORRUPTION

Still another danger sign: the tangled structures of Russian firms. These are a legacy of 1990s-era laws that perversely encouraged Russian companies to establish legal headquarters in offshore havens such as Cyprus. Andrey Posdnyakov, a physicist in the Siberian city of Tomsk, co-founded Elecard Devices, a company that sells audio and video digital-compression technology. He says he registered the business offshore to avoid a tax that Russian authorities levy on local companies' sales to foreign customers. Theoretically, Elecard can obtain a refund of these taxes from the government. "But the procedure is so complicated, you never actually get a refund," says Posdnyakov. Now he has discovered that the offshore registration is a turnoff to potential investors, from whom he hopes to raise $8 million to expand his business over the next two years. Intel Capital, the venture capital arm of the IT giant, has invested in only six Russian companies. It has rejected Elecard and scores of others in Russia because of their complex structures. "We can't invest in companies that have even a slight shadow," says Intel's Konash.

Yet acquisitions can succeed, especially ones involving established Russian brands. In 1998, Unilever purchased a run-down Soviet-era margarine factory in Moscow, gutting the interior and installing new equipment imported from Western Europe. Since then it has snapped up other companies, including Russia's biggest ice cream maker, Inmarko, and the producer of the country's best-known ketchup brand, Baltimor. Nestlé and Danone have cut similar deals.

Corruption is still a problem, though, even when smart companies do their best to avoid it, and even in regions with a business-friendly reputation. An executive of one U.S. company operating in the St. Petersburg area says privately that payoffs are needed for routine tasks such as getting imported supplies cleared through customs. "We use customs brokers, and they build bribes into the invoice," this executive says.

Although many companies say they don't engage in such shady deals, refusing to bribe often complicates their work. Nycomed's Davidsen says setting up the pharmaceutical group's Russian factory will take two or three years longer than it would have in Western Europe, largely because the company has insisted on "100% compliance" with the law at every step of the process, from acquiring land to lining up suppliers to getting approvals from drug regulators.

Russia enacted new anticorruption legislation last year at President Medvedev's urging, but it probably won't make much difference. The law criminalizes only completed acts of bribery, not the act of demanding or offering bribes. Nor does it address widespread corruption in the judicial system.

But the lack of progress doesn't discourage veterans like Stuart Lawson, who worked for Citibank in 11 countries and who now runs HSBC's Russian operations. He's still excited about the market. Russia, he says, offers "some of the most exciting opportunities and some of the finest human capital that I've ever run across." **BW**

–With Miriam Elder in Moscow

Business Exchange

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Taking the R out of BRIC

A new report from consultancy Euromonitor International calls into question whether Russia deserves to be included in the BRIC club. Russia's growth prospects dim next to those of Brazil, India, and China, because of its over-dependence on oil and gas, and a declining and aging population, argue the report's authors.

To view the report, go to: **http://bx.businessweek.com/russian-economy/reference/**

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CHANGE BY DESIGN

By Tim Brown
Photograph by Eric Millette

In his new book, the CEO of design shop IDEO shows how even hospitals can transform the way they work by tapping frontline staff to engineer change

in As the center of economic activity in the developed world shifts inexorably from industrial manufacturing to knowledge creation and service delivery, innovation has become nothing less than a survival strategy. It is, moreover, no longer limited to new physical products but includes new sorts of processes, services, interactions, entertainment forms, and ways of communicating and collaborating. ¶ These are exactly the kinds of human-centered tasks that designers work on every day, and over time they have evolved a body of skills to help them do it. It is time for this type of thinking—design thinking—to migrate outward and upward into the highest levels of leadership. Business leaders, hospital administrators, university professors, and nongovernmental organizations (NGOs) need to integrate the methods of the designer, just as designers need to broaden their reach from the crafting of objects to the shaping of services, experiences, and organizations. Design, in short, has become too important to be left to designers.

When I speak to CEOs, the question they most often ask is: "How can I make my company more innovative?" They recognize that in today's fluid business environment, innovation is key to competitiveness, but they are aware of the difficulties in focusing their organizations around this goal. "How can we incorporate the designer's creative problem-solving skills into our larger strategic initiatives?" "How can we engage a greater percentage of our workforce in design thinking itself?"

Steelcase's Jim Hackett and A.G. Lafley of Procter & Gamble are among a growing number of enlightened business leaders who understand that a steady flow of innovative products rests upon an underlying culture of innovation. While they are excited by the challenge of designing new products, they are even more excited by the challenge of designing the organization itself.

Since Hackett became CEO, Steelcase has come to look like a very different company from the one that offered the world the first fireproof wastebasket back in 1914. Once technology and manufacturing capability drove most of its new-product development. Now the innovation process at Steelcase works outward from the perspective of human-centered design thinking. This new approach is evidenced by Workplace Futures, a unit that operates as a kind of internal think tank and includes anthropologists, industrial designers, and business strategists who conduct observations in the field to gain insights into the problems of Steelcase's actual and potential clients.

Tricks from the designer's toolkit—user observations, brainstorming, prototyping, storytelling, and scenario building—are invaluable in building an innovation capability, but taken by themselves they are rarely sufficient. Over time, and after countless experiences with organizations throughout the world, we have learned that innovation has to be coded into the DNA of a company if there is to be large-scale, long-term impact. All the workshops and brainstorming sessions in the world would not have transformed Procter & Gamble if then-CEO Lafley had not designated a chief innovation officer, increased the number of design managers by more than 500%, and established what he calls his innovation "gym," a place to train managers in the new design thinking.

Companies such as P&G and Steelcase that make products and manage brands have a head start when it comes to trans-





Brown's firm helped Kaiser Permanente's staff boost time with patients

forming their internal cultures because they already have designers, and even some design thinkers, on their payrolls. In service organizations, that base of talent may not exist, and the challenge is greater.

Health-care provider Kaiser Permanente is a case in point. In 2003, Kaiser set out to improve the overall quality of the health-care experience from the point of view of both patients and medical practitioners. My design consultancy, IDEO, proposed that rather than hire a slew of internal designers, the existing staff should learn the principles of design thinking and apply them themselves. Over the course of several months we conducted a series of workshops with nurses, doctors, and administrators that led to a portfolio of innovations. One of them—a project to reengineer nursing staff shift changes—involved a strategist with a nursing background, a specialist in organizational development, a technology expert, a process designer, and a union representative.

Working with frontline caregivers at each of four Kaiser hospitals, the core team identified the problems that occur when shifts change. Departing nurses routinely spent 45 minutes briefing the arriving shift about the status of their patients. The procedures were unsystematic and differed from hospital to hospital, and methods used for compiling information varied from Post-it notes to numbers scrawled on hospital scrubs. Knowledge was often lost, and many patients felt the shift change created a hole in their care. What followed from these observations were the now-familiar elements of a robust design process—videotaping, brainstorming, role playing, prototyping—carried out not by professional designers from IDEO but by Kaiser's own staff.

The result was a complete change in approach. The first prototype, built in only a week, included new procedures and simple software that enabled nurses to call up previous shift-change notes and add new ones throughout their shifts. More important, patients were now part of the process and could bring up additional details important to them. Kaiser measured the impact of this change and found that the mean time between a nurse's arriving on shift and first interacting with a patient was more than halved. The innovation also had an impact on how nurses felt about their job. In a survey, one commented: "I'm an hour ahead, and I've only been here 45 minutes." Another admitted: "This was the first time I've ever made it out of here at the end of my shift."

The new procedure had an impact on patients and nurses but on its own was a long way from achieving the desired goal of a systematic improvement in the overall quality of health care at Kaiser. To achieve that, the core team of nurses, development experts, and technologists went from carrying out their own projects to acting as consultants to the rest of the organization. Through the Kaiser Permanente Innovation Consultancy, the team now pursues the mission of enhancing the patient experience, envisioning Kaiser's "hospital of the future," and introducing innovation and design thinking across the Kaiser system.

The design thinkers I have described here are not minimalist, esoteric members of an elite priesthood, and they do not wear black turtlenecks. They are creative innovators who can bridge the chasm between thinking and doing because they are passionately committed to the goal of a better life and a better world around them. In the process they are helping to make our societies healthier, our businesses more profitable, and our own lives richer and more meaningful. | BW |

From the book Change by Design *by Tim Brown © 2009 Tim Brown (published by Harper Business, an imprint of Harper-Collins Publishers)*

DESIGN PRIMERS FOR BUSINESSPEOPLE

The latest trend in design is books on design thinking



Change By Design

Tim Brown

Businesses can devise radical yet realistic ideas by first looking for patterns in customers' behavior.



A Fine Line

Hartmut Esslinger

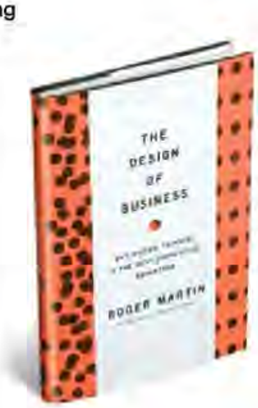
Companies that focus on producing creative, attractive goods are more likely to profit. Just look at Apple.



Design-Driven Innovation

Roberto Verganti

Smart executives align with "interpreters" of technology and culture—industrial designers—to help sell inventions.



The Design of Business

Roger Martin

Corporations can boost productivity by asking managers first to observe problems then imagine solutions.



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HOW TECH FOR THE DISABLED IS GOING MAINSTREAM

By Reena Jana

Designs conceived for the handicapped, such as voice commands for PCs, often lead to products for the masses

in

Apple is widely celebrated for making devices as easy to use as they are elegantly designed. What customers probably don't know is that some of these features aren't exactly new—they evolved from software Apple created to help disabled people use PCs. Among them: the new iPhone's voice control option, which allows users to speak to their handsets to prompt an action, such as calling Mom, or to get a spoken answer to such questions as "What song is playing?"

And "mainstreaming" tools for the disabled is spreading. Software developer Nuance Communications, for instance, invented voice command technology to help people who are unable to type on a computer. Today, the company's algorithms are used in products ranging from Amazon.com's latest Kindle e-reader to cars from Ford Motor. Meantime, Mattel is incorporating technology, initially intended to help paraplegics, into a soon-to-be-released game controlled by players' brainwaves.

Other companies should consider following these trailblazers, say innovation consultants. "Companies could look at designing for accessibility as a sales opportunity. Most features that are accessible for the disabled have great value to everybody," says Donald A. Norman, a former Apple vice-president for advanced technology who heads a joint business and engineering program at Northwestern University.

BENEFITS FOR THE BLIND

Mainstreaming has a long history. Thomas Edison saw his invention of the phonograph as a way to open the printed world to the blind by recording book readings. More recently, predictive-text software, the algorithms that finish words people type in search engines or e-mail, had its roots in technology geared to the disabled, according to patents filed for related programs.

Apple's VoiceOver feature can be traced back to the late 1980s, says Norman, when the computer maker decided to try to embed "universal access" in its Macintosh PC line. The term is used in engineering and design circles to describe goods, from scissors to cell phones, made in such a way that people of any age or physical ability can use them. VoiceOver became a standard feature of Apple computers in 2006. When it's activated, the Mac reads everything highlighted by the cursor, from text on a Web page to numbers in a database, in a natural-sounding voice.

While VoiceOver helped broaden Apple's reach to the blind, it also became a mini-engine for innovation within the company. "When we created the VoiceOver idea and concept for the Mac, we also realized we could take advantage of it by mainstreaming it," says Greg Joswiak, Apple's vice-president for iPod and iPhone marketing.

Now the technology has made its way into the iPod Shuffle. Unlike its larger brethren, the Shuffle is too small to have a screen to display information about its music content. The latest model, introduced last March, gets around this

JESPER WALDERSTEN



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shortcoming with software that can say what song is playing. Sales were 51% higher in the new Shuffle's first week than they were for the previous model's debut, says Barclays Capital analyst Benjamin Reitzes. The low $79 price undoubtedly was part of the reason. But many users raved online about the voice interface, indicating that the feature helped popularize the music player, too.

AT GOOGLE, SOFTWARE TO MAKE ONSCREEN VIDEO CAPTIONS FOR THE DEAF LED TO A TOOL THAT LETS YOUTUBE USERS ADD CAPTIONS IN 50 LANGUAGES

Apple added a reverse version of VoiceOver to its third-generation iPhone, released in June, that enables users to tell the phone to perform functions rather than type commands. That permits hands-free use of the smartphone and makes the device functional for people with visual and other physical handicaps, as well as for motorists. "Some customers need assistive technologies, and other people want convenience," says Joswiak. "We try to solve problems for the disabled community, then we drive the solutions into the mainstream, to let everyone take advantage of them."

The rising demand for devices that can speak and be spoken to has been a boon for Nuance Communications. The Burlington (Mass.) company supplies voice control software for a growing number of products, from its Dragon NaturallySpeaking speech recognition software for PCs to hands-free voice dialing for phones from Nokia, Samsung, LG Electronics, and BlackBerry maker Research in Motion. Through a joint Ford-Microsoft venture called Sync, Nuance also provides voice command capabilities in top-selling GPS navigation devices, such as Garmin and TomTom, as well as in Ford, Lincoln, and Mercury vehicles.

"While the disabled aren't a significant percentage of our users today, they are our biggest power users," says Peter Mahoney, general manager of Nuance's Dragon unit. "They help us push the envelope" when it comes to improving products for mass-market customers.

Other companies are borrowing technology that aids the deaf. At Google, a deaf software engineer, Ken Harrenstein, spearheaded the creation of a captioning tool for videos posted on Google's YouTube site. His original intention was to help deaf users. But the company soon figured out the software could also help translate languages. That idea led in late 2008 to an auto-translation tool that allows people to add captions in 50 languages instantly to YouTube videos they upload, increasing the number of people who can watch and understand the clips.

MIND CONTROL

Mattel is taking mainstreaming into the toy market. In October it plans to release Mindflex, an $80 game that borrows from technology used by severely disabled people to control electronic devices by channeling brainwaves via sensors. Mattel has licensed the toy's brainwave-harvesting technology from a San Jose company called NeuroSky. To play, users put on a headband with sensors. By focusing their thoughts on motion, they can cause a motor to propel small plastic balls through a tabletop obstacle course. When they relax, the objects stop moving.

Mattel is betting that the technology will become the basis for a line of mind-controlled physical games like Mindflex, opening up a new category for the toy industry, says Geoff Walker, a senior marketing vice-president at the El Segundo (Calif.) company.

As pioneers boost sales by incorporating technology once confined to products for the handicapped, other companies are sure to follow. They could come out ahead, says Tim Bajarin, president of technology consultancy Creative Strategies in Campbell, Calif. "It's smart, because there is an aging population that will need easier-to-use tech. It's even smarter to follow Apple's lead—and then call these features out and get people's attention. Then it becomes a competitive advantage." |BW|

MORE APPLICATIONS THAN FIRST IMAGINED

COMPANY	PRODUCT, RELEASE DATE	TECHNOLOGY FOR THE DISABLED	MASS-MARKET APPLICATION
Google	YouTube caption tool (October 2008)	Onscreen video captions for the deaf	Onscreen text allows for instant language translation
Amazon	Kindle second-generation e-book reader (February 2009)	Text-to-speech synthetic voice for the blind	Turns electronic books into audio books for use when driving
Apple	iPod third-generation Shuffle MP3 player (March 2009)	Screen reader allows blind to use computer	Voice-only device eliminates need for a display screen
Mattel	Mindflex game (October 2009)	Brainwave reader helps the paralyzed move objects	Hands-free movement of physical toys

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- Steve Center, Honda
- Rachel Richards, Sonic
- Rudi Thun, AOL
- John Holt, Cobalt
- Cindy McColley, General Motors

Moving Online Leads to Offline Sales moderated by Angie Sherrell of GS Marketing with panelists:

- Clayton Stanfield, eBay Motors
- Todd Smith, ActivEngage
- Jim Flint, John Eagle Honda
- Pete Dalamaggas, Toyota of Des Moines

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MANAGEMENT & LEADERSHIP

GM: His Way Or the Highway

Chairman Ed Whitacre doesn't mind bruising egos to make the carmaker profitable again

By David Welch

Edward E. Whitacre Jr. is a rarity in American business: a nonexecutive chairman who behaves like an executive. Since the U.S. government named the former AT&T boss chairman of General Motors, Whitacre at times has acted as though he were CEO, the job actually held by Frederick A. "Fritz" Henderson.

Nonexecutive chairmen rarely venture far from the cozy confines of the boardroom, let alone challenge management before outsiders and low-level staff. Yet Whitacre has done exactly that, warning darkly that if current executives don't get GM back on track, they can always be replaced. He also meets with employees and dealers to talk about strategic goals and GM's calcified culture. Whitacre, who is 67, even stars in GM's new TV commercials. "It's a little bizarre," says Charles M. Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware. "You run the risk the chairman will undermine the CEO's authority."

Part of the flurry of activity reflects the fact that Whitacre, an industry outsider, is learning on the job. Henderson, as one might expect, maintains his boss doesn't get involved in day-to-day business. As for Whitacre's not-so-subtle implication that Henderson's job is on the line, the CEO says: "That's Ed's style. What you see is what you get. Ed is very blunt." Marketing chief Robert A. Lutz adds: "He's an activist chairman. He cajoles, motivates, and uses the occasional veiled threat to induce fear." Whitacre declined to comment for this story, but has said Henderson has the board's support.

Activist Chairman

Government-appointed Whitacre wants his managers to:

- Boost U.S. market share north of 20% in 2010, though some analysts expect it to slide from 19.4% now to 15% over the next couple of years
- Bring cars to market much faster, though GM currently matches its peers
- Stop griping about slow decision-making and help change the culture themselves

The GM chairman is under enormous pressure from his government minders, who profess themselves determined to extricate the Obama Administration from the company next year. Treasury officials told Whitacre to lean hard on Henderson to change GM's culture and show results quickly. Whitacre, by all appearances, has taken his mission to heart.

TRANSFORMING A CULTURE

On Aug. 3, shortly after GM emerged from bankruptcy, the board held its first meeting at the automaker's sprawling Tech Center in Warren, Mich. Afterward, Whitacre told Henderson that the board wanted a path to growth and a means to measure progress. The previous board had essentially rubber-stamped management's strategy. Henderson, say two people familiar with the meeting, told Whitacre that he wouldn't be losing any sleep over the new board's orders. Whitacre, these people say, told Henderson that he would be wise to take the directors seriously.

Not long after, Whitacre held a series of so-called diagonal slice meetings, a long-standing GM practice in which top executives seek feedback from white-collar people at all levels of the company. During one of the meetings, according to one person briefed on the sessions, Whitacre said he wanted to see progress in 12 weeks or managers could be replaced. His comments rippled through the company, putting people on edge.

Part of Whitacre's strategy is to transform a cautious culture into one that takes risks. Henderson and Lutz wanted to spend hundreds of millions of dollars on GM's post-bankrupcty ad campaign. They fretted that tight budgets would short-change the push. But when they met Whitacre for lunch at his San Antonio club in July, the


Whitacre

Henderson and his team have been pushing back. Thomas G. Stephens, the newly promoted vice-chairman of product development, says GM is already running hard and gets its newest models to market as fast as any other company. Henderson and his team prepared a tutorial for a board meeting in early September that detailed the process of designing and engineering a new car. "We just need to educate them on how long it takes," Henderson says. He adds that the board was receptive to what he and


Henderson

chairman didn't balk. "Let's not be prisoners of short-term profits," Lutz recalls him saying.

Whitacre also has set market-share targets, typically the CEO's call. Insiders say he wants GM's U.S. share, currently at 19.4% and down more than two points from last year, to get north of 20% next year. And he wants to achieve those gains without profit-killing rebates. How much of a stretch is that? A big one. GM has shrunk its family of brands, vehicle lineup, and manufacturing capacity. In fact, the board has questioned management about the product line, wondering if there are enough new cars to hold GM's current share, let alone hit Whitacre's goals.

PRESSURE TO REPAY TAXPAYERS

Not that Whitacre and the board are backing off. Instead, says one GM executive, they are demanding the carmaker bring new vehicles to market faster. One product development executive worries that GM's slimmed-down white-collar ranks mean rushed


Lutz

projects are a real challenge. He and his colleagues also fret that the board's new directors, all from outside the industry, don't yet know how long it takes to get a car from the sketch pad to the showroom. "They are asking us to cut development times by one-third," says this person. "If it's a 36-month program, they want the car in 24 months. It is being suggested that we have to work faster than ever."

his team presented and so far has been supportive of GM's new models.

U.S. manufacturing czar Ron Bloom and his counterparts on the President's auto task force may not be meddling in daily operations, but they want GM to stand on its own as soon as possible. That includes repaying most of the $50 billion the company owes the U.S. government, plus the $9 billion owed Canadian taxpayers. That's why Whitacre is pushing Henderson so hard.

On Sept. 9, Whitacre, Henderson, Lutz, and other executives met at the Westin Detroit Metro Airport Hotel to show 15 top dealers the company's new ad campaign. After the presentation, say three dealers who were there, Whitacre rose from his seat. Dispensing with all but the most perfunctory of pleasantries, he told the group that he expected GM to start growing again as soon as possible. Then, to the shock of the dealers, who had never before heard a GM executive speak so bluntly, Whitacre said: "If we don't get this done, we'll find someone who can." | BW |

ILLUSTRATIONS BY LARA TOMLIN



MANAGEMENT & LEADERSHIP

Vikram Pandit On the Record

Citi's CEO talks about regulation, level playing fields, executive bonuses, and Washington's role at the bank

Citigroup, which has been at the epicenter of the financial crisis, is one of the best-performing U.S. stocks since March. But CEO Vikram Pandit's fix-it job is far from complete. Citi's shares remain 90% off their high in 2006. Its books are still loaded with risky assets. And the economy faces headwinds. Pandit sat down to talk with *BusinessWeek* Editor-in-Chief Stephen J. Adler on Sept. 17 as part of the Captains of Industry series at the 92nd Street Y in Manhattan. Here are some excerpts of their conversation:

STEVE ADLER

What's it like to have the government owning 34% of your company? What's the relationship?

VIKRAM PANDIT

They're not in our board meetings. They're not involved in day-to-day management. I know there may be a perception that there is something more meaningful here as part of the stake that they own. But outside of the regular conversations that we and other regulated institutions have with their regulators, we are responsible.

I wanted to ask you about Sheila Bair, the chairman of the Federal Deposit Insurance Corp., who has reportedly criticized Citi's management team. Isn't that kind of a bad enemy to have?

I'm not going to comment on any particular regulator. What I can say is that we're now all aligned with our regulators. They want us to succeed. They want us to be stable. They want us to grow. They want us to be profitable. All we need to do is just keep executing.

President Obama recently gave a speech on Wall Street where he seemed to be chiding the industry for not supporting the regulation he thinks is needed and for not participating as much in the solution. What is your view of the speech?

I think the regulatory plan the Administration is thinking about is based on the right principles. We need level playing fields around the world. We need to make sure you don't have a banking system that's regulated and a shadow banking system that's unregulated. Those are the same principles that most of the Group of 20 nations are talking about. It's not about the U.S. It's about how the world all agrees to the same principles because money flows everywhere around the world.

Should there be a single, global regulator?

I'm not sure you need that as much as you need the same types of rules. If you have global standards, then you can have different regulators.

What about the proposal for a Consumer Protection Agency?

DANIEL ACKER/BLOOMBERG NEWS

> **"We're going to be 40% smaller in our balance sheet vs. where we were when all of this got started"**

In general, making sure banks and other financial-services companies are doing right by their clients is a good thing. But on the other hand, you want to make sure that as you think about what's right for consumers, it's in the context of the fact that these entities also run businesses. It is an important detail to work out.

The theory, you're for it? But you may run into trouble on the details?
Isn't that the case about everything?

There is a dispute about the $100 million pay package for Andrew Hall at Citigroup's energy-trading unit, Phibro. Do bankers make too much money?
There are compensation structures that actually create what's called moral hazard: Heads I win, tails you lose. [Such a structure] drives you to take excessive risks. So the art of compensation is really about driving the right behavior. In my business talent is my most important asset. I want to create an environment where [employees] are recognized for performance, where they operate within the right culture, where they're paid competitively.

Aren't there some sums that are just too much, like $100 million?
Yes.

It seems Citi has shifted from a financial supermarket model to a traditional banking model. Is that a correct assessment?
We've turned the company from a balance-sheet-intensive, risk-lending-oriented company to a client-facing business, which is about loans, services, things of that sort. That's a substantial shift. In our own case, we're going to be 40% smaller in our balance sheet vs. where we were when all of this got started.

What kind of recovery will it be?
You really have to disaggregate the world. Look at Latin America, below Mexico. The economies are doing well. The same thing is true in India and certain Southeast Asian countries. [China's] doing well because of government spending. That leaves us with the U.S. and Europe. We like what we're seeing out there [in the U.S.]—stability. We like what we're seeing in terms of inventory. Some businesses are hiring people back. But we've got to appreciate that this recovery is happening against the backdrop of some of the worst imbalances in economic history. It's not going to feel like a recovery for a while because we're going to have to work out these imbalances.

Where would you say GDP growth is going to be in 2010?
I'm less interested in what the number is. I'm more interested in the shape of the recovery. Does it snap back and then stay flat? Or is it steady growth? Those are the things we're watching. But it's really too early [to tell].

Is Citi a good investment?
Well, I have two responses to that. Anything that's good for the government should be good for all of us. Second, whether you know it or not, you own it as well.

But are you recommending the stock because it is going to go up?
How can a CEO not like his stock? Obviously we've gone through a lot of painful decisions. But the result is we are in an extremely strong financial position. We have a clear strategy and a very good management team that's executing extremely well. That's the fundamental side. The other side is we're trading at book value. Other banks are trading at 1.6, 1.8 times book value. If you look at the valuation, we feel that there is an upside. |BW|

BUSINESSWEEK.COM | To watch *BusinessWeek* Editor-in-Chief Stephen J. Adler's interview of Citigroup CEO Vikram Pandit in its entirety, go to businessweek.com/go/09/pandit



Carbon Curbs: It's Business vs. Business

As some powerful corporate groups fight a U.S. climate bill, others are leading a counterattack

By John Carey

Even as the health-care fight rages, another fraught issue is back in the headlines: What to do about climate change. While the debate includes the familiar partisan split, this particular topic also pits conservative against conservative, business against business, and country against country.

At the Group of 20 meeting in Pittsburgh in late September, world leaders will be pressing the U.S. to act on the matter. Washington got only part way there when the House of Representatives passed a landmark bill putting caps on carbon emissions in June. The Senate has yet to take up the issue. And thanks to powerful opposition from business groups such as the National Association of Manufacturers, the American Petroleum Institute, and the U.S. Chamber of Commerce, the chances of Senate action have dimmed, many experts believe. The opponents "clearly have the jump on us," acknowledges Betsy Moler, lobbyist for Chicago utility Exelon, which strongly supports the bill.

Now Exelon and others are mounting a counterattack—and they believe they have a fighting chance. One of their arguments: If Congress doesn't act, business could face tougher rules from the Environmental Protection Agency. "Climate action is inevitable," says Michael G. Morris, CEO of Columbus (Ohio)-based utility American Electric Power, who is pushing for a bill. "The only choice is whether to encourage the Senate to pass comprehensive, well-crafted climate legislation or to wait for the EPA to enact regulations under the Clean Air Act."



AEP's Morris says climate regulation is "inevitable," whether via the EPA or legislation

STEPHEN VOSS

Exelon is one of the leaders of a coalition of companies working to get out the message that a big chunk of American business—from Alcoa and General Electric to the utility industry—believes carbon caps and policies to boost cleaner energy are crucial (table). The latest sign of a rift in business: California utility PG&E pulled out of the Chamber of Commerce to protest that body's opposition to climate legislation.

Some companies also worry about the effects of global warming. Levi Strauss, for instance, fears that rising sea levels, floods, and other changes could threaten factories in such places as Bangladesh. The companies are planning a blitz of op-ed articles and media campaigns, while leaders such as Exelon's Republican CEO, John W. Rowe, will plead the case in the Senate.

Meanwhile, environmentalists are stepping up their own advocacy efforts. In early September more than 60 groups launched a multimillion-dollar campaign, dubbed Clean Energy Works. "It's clear that just negotiating is not going to work," says David Goldston, director of government affairs

FEUDING OVER CLIMATE CHANGE

AGAINST A CLIMATE BILL			FOR A CLIMATE BILL		
AMERICAN PETROLEUM INSTITUTE	NATIONAL ASSOCIATION OF MANUFACTURERS	U.S. CHAMBER OF COMMERCE	ELECTRIC UTILITIES	CHEMICAL MAKERS DOW AND DUPONT	LEVI STRAUSS AND NIKE
Oil producers and refiners can lose out with shift to non-fossil fuel energy	Fears manufacturing jobs will move offshore	Claims climate rules would be a massive tax hurting U.S. companies	See curbs as inevitable, want clear rules, and prefer legislation to EPA regulation	Say climate change is real, anticipate new markets, and have already cut emissions	Are worried about global warming's threat to, say, factories in Bangladesh



at the Natural Resources Defense Council. "So we created this war room."

The contest will be fought across the country. Yet ultimately the fight is "really about the hearts and minds of about 20 people," says Exelon lobbyist Moler—the swing votes in the Senate. On the list: more than a dozen moderate Democrats, such as new Senate Agriculture Committee Chair Blanche Lincoln of Arkansas.

JOB CREATION

Opponents say a climate bill would cripple the economy. "Our message to Senators is that the bill is an anti-jobs, anti-energy piece of legislation," says Jay Timmons, executive vice-president of the National Association of Manufacturers.

But proponents of carbon caps insist they also have a good hand to play. For one thing, polls show that Americans favor what emissions curbs would encourage, namely a shift to cleaner, greener energy. "Even those who deny climate change are supporting clean energy and energy independence," says Maggie L. Fox, CEO of the Alliance for Climate Protection.

That's why supporters of the climate bill have largely stopped trying to scare people with dire predictions about global warming. Instead, they're planning to hammer home the message that legislation would bring green jobs and a cleaner environment while enhancing national security by reducing dependence on foreign energy sources.

When the Senate begins to take up the climate issue, though, supporters will have one scare message for lawmakers. If Congress doesn't act, the EPA will step in with potentially more onerous emissions curbs. Adding another legal threat, on Sept. 21 a federal court ruled that companies can be sued over their emissions. Congress isn't yet fully aware of these alternatives, says Keith Belton, director of government affairs at Dow Chemical. "I'm surprised by how many people think the choice is between legislation or nothing."

The battle ahead will be messy. The bill's opponents are stoking the same Big Government fears that have made health-care reform so divisive. Meanwhile, some environmental activists oppose the current House bill for being too weak, while groups such as farmers and natural gas producers are lobbying for more payouts than they got from the House. As a result, a Senate bill "will be very different," predicts AEP's Morris.

Much also depends on how hard the White House pushes. There, the signals are growing stronger. "We understand the gravity of the climate threat," President Barack Obama told the U.N. Summit on Climate Change on Sept. 22. "We are determined to act." | BW |

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Dissension in the Ranks

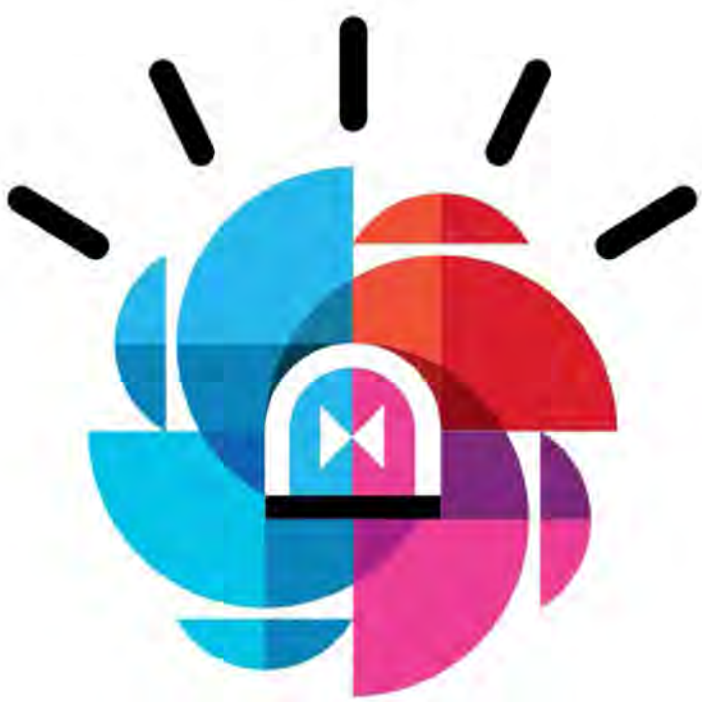
U.S. companies are grappling with how to quantify risks associated with climate change. *The Washington Post*, in a Sept. 21 story titled "Firms Start to See Climate Change as Barrier to Profit," notes that some members of the National Association of Manufacturers now support climate legislation of the sort their trade group opposes.

To read this story and others like it, go to **http://bx.businessweek.com/global-climate-change/reference/**

CLEANTECH INDUSTRIES: SOLAR, WIND

Climate rules would be a boost to cleaner energy and energy efficiency

Note: Many other large multinationals, including GE, Shell, and Johnson & Johnson, already operate under European climate rules. They would like to see worldwide standards.



New York has smart crime fighting.



INNOVATION & TECHNOLOGY

Finally, a Big Green Apple?

It's being more forthcoming with environmental data—and working to change the terms of the debate

By Peter Burrows

In recent years, Apple has been hammered by several environmental groups. Greenpeace singled it out for its use of toxic chemicals in 2007, and it has done poorly in rankings of the greenest corporations. The criticism is jarring for a company with a cool, progressive image and Mr. *Inconvenient Truth,* Al Gore, on its board.

Now, Apple is set to launch its most aggressive effort yet to counter green critics. On Sept. 24, the company will release more of the details environmental groups have been clamoring for, on its Web site and elsewhere. Apple, for example, will reveal its annual corporate carbon emissions for the first time. Lack of disclosure of that figure has hurt the company in several rankings, especially because rivals such as Hewlett-Packard and Dell have given it out.

Apple's real goal is to change the terms of the debate. Company executives say that most existing green rankings are flawed in several respects. They count the promises companies make about green plans rather than actual achievements. And most focus on the environmental impact of a company's operations, but exclude that of its products.

Apple argues that broader, more comprehensive figures for carbon emissions should be used—for everything from materials mined for its products to the electricity used to power them—and it's offering up its own data to make the case. Executives say that consumers' use of Apple products accounts for 53% of the company's total 10.2 million tons of carbon emissions annually. That's more than the 38% that occurs as the products are manufactured in Asia or the 3% that comes from Apple's own operations. "A lot of companies publish how green their building is, but it doesn't matter if you're shipping millions of power-hungry products with toxic chemicals in them," says CEO Steve Jobs in an interview. "It's like asking a cigarette company how green their office is."

Apple's total carbon figure is an eye-opener. HP and Dell put their carbon emissions at 8.4 million tons and 471,000 tons respectively, though both are larger than Apple in terms of revenue. Their numbers exclude product use and at least some manufacturing, though. The companies have said that including those factors would boost their carbon totals severalfold.



Steve Jobs says that "Greenpeace was being very unfair to us"

Jobs and Apple have been working on their effort for several years. They brought in the consultant Fraunhofer Institute to help crunch data and hired chemists to eliminate toxins. The company is disclosing its data days after it was beaten out in another green ranking by Dell, Hewlett-Packard, and IBM, but Jobs says that was not the reason for the timing of its disclosures. "This is when we just got the work done," he says.

Some environmental experts applaud Apple's move. They say green rankings have been limited by the data companies provide, and Apple is setting a high bar for calculating and disclosing carbon emissions. "This could completely change how companies are evaluated," says Alexandra McPherson, project director with Clean Production

CARL WIENS; PHOTOGRAPHY BY JEFF CHIU/ AP PHOTO

Action, an environmental group.

Other experts aren't so sure. Some say companies shouldn't get credit or blame for the carbon emissions from their products, because such data can be manipulated. Apple may be trying to count the impact of products simply because such calculations make the company look good against its peers. "All of these companies report in ways that favor their business model," says Conrad MacKerron, director of corporate social responsibility programs at the As You Sow Foundation, a corporate accountability group.

RAMPING UP RECYCLING

Apple counters that it's time for companies, in tech and elsewhere, to examine their environmental impact as broadly as possible. For tech companies, that should include the energy-gobbling products they sell. "We're not being intellectually honest with ourselves if we don't deal with the products that we make," says Timothy D. Cook, Apple's chief operating officer.

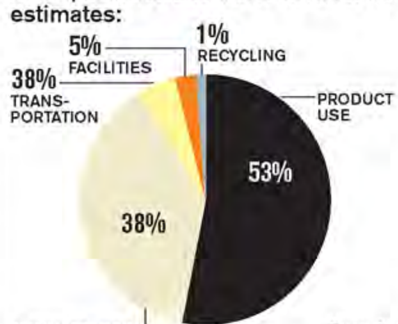
The company is disclosing new product information, as well as overall carbon emissions. Apple will document on the new Web site data that it ended the use of controversial polyvinyl chlorides (PVCs) and bromide flame retardants (BFRs) in its devices last year. HP and Dell had promised to do the same by 2009, but recently pushed that back. Apple is also going further and pushing suppliers to get rid of bromine and chlorine, the harmful ingredients in PVCs and BFRs.

Jobs admits criticism from Greenpeace and others motivated Apple to improve its environmental efforts, but he fumed over the tactics at the time. Greenpeace attacked Apple because it wouldn't publicly set long-term goals for carbon reduction and toxic removals. Jobs says it's more important to deliver results than make promises, noting that Apple was the first computer maker to ditch CRT monitors in all its products because they contain lead. "I thought Greenpeace was being very unfair with us at the beginning, and that they were using us to get visibility," he says. "To have people saying we didn't care and that we were callous in this area was very painful—and untrue."

Jobs insists he won't start setting long-term environmental targets to satisfy critics. But Apple is becoming more transparent on its Web site and other fronts. Last year, the Carbon Disclosure Project put Apple near the bottom of its rankings for corporate disclosure, with seven points on a 100-point scale. On Sept. 21, when the group released its 2009 rankings, Apple scored a 73. Paul Dickinson, president of the project, says Apple's effort to make measurement of carbon impact more comprehensive is a step in the right direction. "Its approach is legitimate, and to be encouraged," he says. |BW| *–With Arik Hesseldahl*

ENVIRONMENTAL BREAKDOWN

Apple says it generates 10.2 million metric tons of carbon emissions annually, from manufacturing, the use of its products and other factors. Its estimates:



Data: Apple

Business Exchange

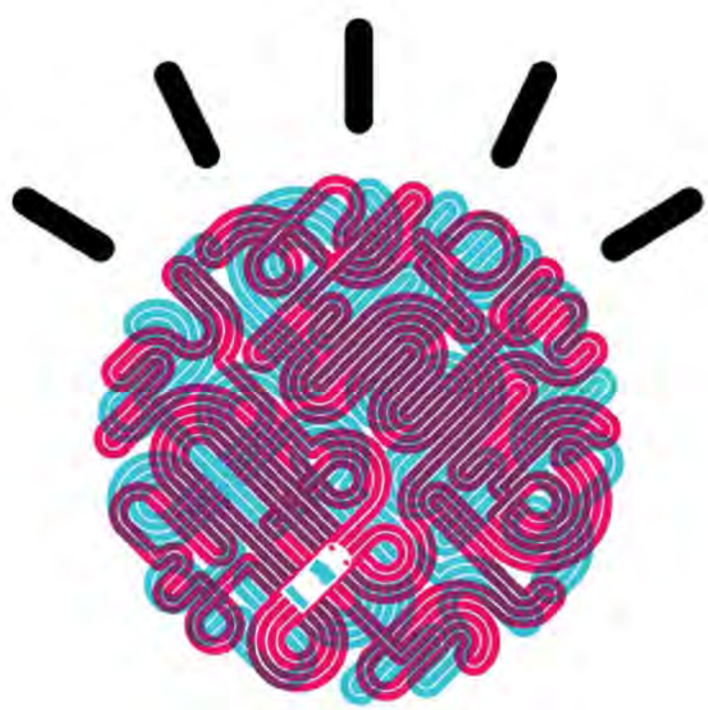
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Eco Laggard

Apple has done poorly in several environmental rankings, including *Newsweek*'s report on The Greenest Big Companies In America in its Sept. 21 issue. Rivals Hewlett-Packard and Dell ranked first and second on the list, while Apple was miles behind at 133. The company suffered in part because it hasn't set long-term environmental goals publicly.

For *Newsweek*'s coverage, go to **bx.businessweek.com/green-business/reference/**

RAY VELLA/BW



Stockholm has smart traffic.



McDonald's Trafani in a Paris McCafé, where lower prices are helping to nab Starbucks loyalists

ED ALCOCK

STRATEGY & COMPETITION

Europe's New McCafé Culture

Low-cost expansion is helping McDonald's vie with Starbucks as the Continent's No. 1 coffee chain

By Leona Liu



PARIS

The Left Bank café is furnished with sleek wood paneling and leather armchairs. Patrons sip espresso from china cups and nibble on croissants and pastries. So what are those golden arches doing on the sign outside the door?

The coffee shop on rue Linois is one of 200 "McCafés" McDonald's is opening in Europe this year. By yearend, McDonald's hopes to have some 1,100 of the cafés across Europe. The cafés are located inside existing restaurants but with a separate counter, comfy furnishings, and nary a Big Mac in sight. Next year, the company plans 200 more, with an eye toward becoming "the No. 1 coffee seller in Europe," says Jerome Tafani, the company's chief financial officer for the region.

That's a grande order. Starbucks is currently Europe's top coffee chain with nearly 1,200 stores. But McDonald's strategy of opening McCafés in existing franchises gives it a leg up over the Seattle-based java king. A stand-alone Starbucks in Europe requires an investment of $350,000-plus, at least triple what a McCafé costs, says Jeffrey Young, managing director of London management consultancy Allegra Strategies. "McDonald's finally woke up and smelled the coffee," says Young. "With the number of outlets it already has in place, it can take Starbucks head-on."

McDonald's is rushing to grab market share where Starbucks has hesitated. While Starbucks continues to avoid Italy, for instance, McDonald's opened its first Italian McCafé in Milan in 2005. Today it has 65 of them across the country. And McDonald's is undercutting Starbucks on price. At McCafés in Paris, an espresso costs $2.50, vs. $2.80 at Starbucks.

1,300

McCafés in Europe by end of next year. Starbucks has 1,193 stores in the region.

Data: McDonald's, Starbucks

That's not to say you'll find McCafés everywhere. In Britain, where Starbucks has 700-plus stores, McDonald's has no plans for McCafés. And while all 13,900 U.S. McDonald's outlets now sell McCafé coffees, the company isn't building separate café sections there, either. Since 70% of orders come from the drive-through window, franchisees don't want to install a second counter. But in Europe, where fast food is a bit slower than across the Atlantic, fewer than half of McDonald's orders are to-go.

A CAFFEINE BOOST

European franchisees like McCafés because they encourage customers to stop in for breakfast and during off-peak hours. Store revenues jump 20% to 25% after adding a new McCafé, says Michael Heinritzi, McDonald's No. 1 European franchisee, with nearly 40 stores across Germany and Austria. And the cafés increase McDonald's appeal to women. "It's impossible to bring [children] to a traditional French café," says Nelly Bourji, a Parisian who drops in at a McCafé once a week. "You can't all fit around the tiny tables." As for Starbucks, she says, "There are too many teenagers."

Bourji isn't the only Starbucks loyalist to jump ship. At a McCafé on the Autobahn near Munich, former Starbucks patron Tobias Ullmann is sipping a mocha frappé. The restaurant features a gas fireplace inside and three terraces with views of the Alps. "I always stop here on my way to Austria or Italy," says Ullmann, an insurance agent from the German city of Ingolstadt.

Still, one of the biggest challenges for McDonald's will be to shake off its fast-food image. For some, the idea of lingering in a McCafé remains unthinkable. "I don't care how good their coffee is," says Parisian Jessica Dollé, 18. "The smell when you walk into a McDonald's is so greasy, it's nauseating." |BW| *–With Moira Herbst*

STRATEGY & COMPETITION

OXO Gets a Grip On New Markets

The maker of popular kitchen tools is extending its brand to medical devices and children's products

By Reena Jana and Helen Walters

OXO's kitchen and household products are winners with consumers, from its rubber-gripped potato peelers to its no-leak travel cups. The eye-catching designs have been featured in museum exhibitions and, despite premium prices, have continued selling well during the recession. OXO's parent company, Helen of Troy, reported an 11% bump in revenue from housewares in its spring quarter.



OXO's Lee with a new syringe designed for rheumatoid arthritis patients

BILL WADMAN

Having exhausted much of its original market, OXO is now branching out to office supplies, medical devices, and baby products. But the new lines also expose OXO to added risks. Established rivals already have loyal customers. And shoppers may balk at paying up to five times more for an OXO staple remover than for a store brand. OXO President Alex Lee sees only promise. "At every dinner I go to, someone says, 'OXO should make ... a garage door opener!' Just fill in the blank," says Lee, 49.

FOR GNARLED FINGERS

OXO's latest ventures are separate partnerships with Staples and UCB, a pharmaceutical company in Belgium. UCB's new syringe bears the hallmarks of an OXO design, from the large, smooth thumb pad on top of the plunger to the oblong shape of the barrel, which won't spin or slip in gnarled fingers. The prefilled device, which became available in May, is designed specifically for rheumatoid arthritis patients who use it to self-inject UCB's drug Cimzia.

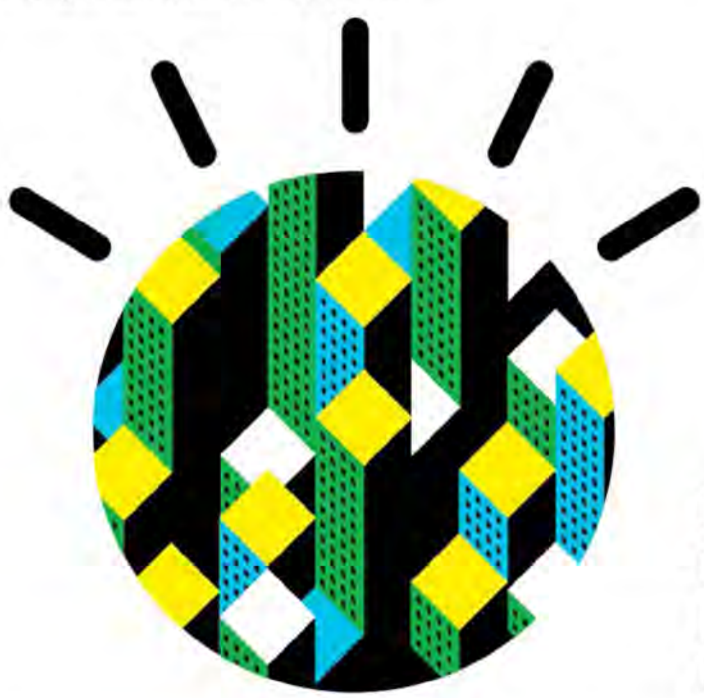
A easy-to-use syringe isn't exactly a design breakthrough, however. Abbott Laboratories created one for rheumatoid arthritis patients back in 2002. Since 2006, Abbott has been offering an even simpler device, a push-button "auto-injector" for its drug Humira, which is already further away from the typical needle than OXO's design.

Staples began stocking two dozen OXO products in May, including a $7.99 tape dispenser and a $24.99 three-hole punch. The 2,200-store chain won't disclose figures, but it plans to extend the line of OXO Good Grips products later this year.

OXO Tot is the company's next frontier. The collection of 69 products for babies and toddlers includes high chairs that convert to big kids' seats. The high chairs took only two years to develop. "We are heavy users of most of the products we decide to work on," Lee says. That means OXO doesn't have to spend as much on research to learn what makes a product better. The Tot line will hit the stores in January. |BW|

Let's build a planet of smarter cities.

This October, leaders and forward thinkers from some of the smartest cities on the planet will meet at a "smarter cities" summit in New York and share ideas about smart healthcare, smart traffic, smart water management, smart energy and more. Join us and see what others are thinking at ibm.com/smarterplanet



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Lowering the Bar For Stock Listings

To boost revenue as trading volume slips, the NYSE is relaxing requirements

By Mark Scott

Investors are benefiting from the stock market rally, but the major U.S. exchanges still have little reason to celebrate. Trading volumes are way off their highs, and upstarts continue to steal market share. With revenues slipping, the bourses are scrambling to protect an old-fashioned business: listings and the fees companies pay the exchanges to trade their shares. The NYSE Euronext has been the most aggressive, going so far as to lower the threshold for listing with it—a move that ultimately could hurt investors.

For years the established exchanges were considered the arbiters of quality. Companies' reputations got a boost when they traded their shares on the NYSE or Nasdaq OMX, which had the strictest listing standards, including criteria for market value and share price. "They were seen as the gold standard," says Susanne Kloess, a managing director at consultant Accenture.

But with the market in free fall last year, the NYSE and Nasdaq temporarily waived some listing requirements. For example, both venues allowed companies to continue trading even if their prices fell below $1, typically the level for delisting. The bourses argued such steps were necessary to ensure that investors could buy and sell major stocks during the turmoil. By late spring, hundreds of companies, including American International Group, Citigroup, and Fannie Mae, didn't meet the price, market cap, or other



standards. "We were dealing with extraordinary circumstances," says Scott Cutler, NYSE Euronext's head of listings in the Americas.

The changes may have been financially motivated for the NYSE. While Nasdaq reinstated its standards as the stock market recovered, the Big Board made some permanent. In June the NYSE opted to keep its minimum market value at $15 million, rather than raising it back to $25 million. That move will allow small, struggling companies to keep their listings.

PLAYING CATCH-UP

The U.S. exchanges are wooing new companies, big and small. Historically, New York-based bourses won the lion's share of initial public offerings. But they've been playing catch-up since the recession blackened the reputation of the U.S. financial industry. So far this year the exchanges in Shanghai, Hong Kong, and São Paulo have captured the bulk of the IPO deals worldwide, including China State Construction Engineering and Brazil's VisaNet.

To win back business, U.S. exchanges are lowering the hurdles and offering extra incentives. The NYSE now allows new companies with no revenue a place on the exchange as long as they meet other standards. "The changes help shore up their defenses against competition," says Phillip Silitschanu, senior analyst at advisory Aite Group. To court companies, the exchanges also are providing data, marketing promotions, and other value-added services as part of their deals for listings.

With rivals outmuscling exchanges in their mainstay business, the fees from listings have become increasingly important. New, computerized rivals can siphon off trading activity, but companies can only list their shares with the major exchanges worldwide. During the slump, such fees have been the only steady source of revenue. NYSE listings pulled in $200 million in the first half of 2009—or 17% of revenues. That compares with 12% in the same period last year. Says Axel Pierron, senior vice-president at consultancy Celent: Listings are "very profitable. Exchanges have to hold on to [them] any way they can." |BW|

Business Exchange

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Whoa, IPOs

Unlike in the U.S., Chinese authorities want to temper the market for IPOs. A *Wall Street Journal* article reports that the Securities Association of China is making it more difficult for U.S. money managers to buy shares in newly formed Chinese companies that debut on the local exchange.

To read the full piece, go to **http://bx.businessweek.com/initial-public-offering-ipo/reference/**

KOREN SHADMI

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MONEY REPORT

TRADING ON E*TRADE

Is E*Trade Financial down so far that it's looking up? On Friday, Sept. 18, Goldman Sachs upped its rating on the long-suffering online trader and home lender to "buy," following Citigroup's similar upgrade earlier in the week. Shares soared 8% to close at 1.84. The next Monday they rose further, topping 2 at midday, some 3.5 times their low of 0.59 in March. ¶ The good news is that E*Trade may be moving beyond its credit problems. Goldman forecasts that it will return to profitability by the end of 2010. Also, E*Trade showed trading volume gains in August of 18% over the previous month and 37% over the previous year. The big question: whether E*Trade—whose chief executive, Donald Layton, is stepping down by yearend—is takeover bait. With the shares up so much, caveat investor. As Barclays Capital analyst Roger Freeman, who rates the shares "neutral," writes in a recent research note: "We believe [investors] are already discounting a fair amount of the macroeconomic improvement that we have already seen." *–Amy Feldman*

BONDS

THE PREFERRED APPROACH

High-yield bonds aren't the only risky asset to benefit from investors' renewed quest for higher returns. Preferred stocks, which trade like equities but earn most of their return from fixed dividends, have more than doubled from their March low—they were down nearly 50% during the first two months of 2009. (The stocks are "preferred" because their holders receive dividends before shareholders of the common stock get paid.)

On Sept. 17, State Street launched the SPDR Wells Fargo Preferred Stock ETF, which competes with two other exchange-traded funds, the PowerShares Preferred Portfolio and the iShares S&P U.S. Preferred Stock Index Fund. Like those two, the SPDR boasts a hefty dividend yield—topping 8%—and has a portfolio that is more than 80% financial companies. But it tries to reduce some of the risk by maintaining a highly diversified portfolio—it holds 164 securities, more than the other two funds combined (the PowerShares fund has 67, the other 94). Says Matt McCall, a financial adviser with Ridgewood (N.J.)-based Penn Financial Group: "It's a more conservative approach." *–Ben Levisohn*

-46.8%

Total return of the iShares S&P U.S. Preferred Stock Index exchange-traded fund from Dec. 31, 2008, to Mar. 9, 2009

+148.4%

Total return of the iShares S&P U.S. Preferred Stock Index exchange-traded fund from Mar. 9, 2009, to Sept. 21, 2009

Data: Bloomberg



US NAVY VIA BLOOMBERG NEWS

STOCKS

HIT OR MISS?

Shares of Raytheon rose 5%, to 48.33, in the two trading days after President Obama's Sept. 17 announcement of a change in plans for a missile defense system in Eastern Europe. The defense contractor is expected to benefit from deployment of a new strategy that uses its Standard Missile-3. But analysts at JPMorgan cite big risks, including U.S. defense budget cuts and delays in the awarding of international contracts because of the downturn. They do expect a slight gain by December, to 52. "Its international growth prospects" and low-debt balance sheet "could still yield some modest expansion," according to JPMorgan. But at 52, the stock would be at breakeven for 2009. An index of S&P 500 aerospace and defense companies, meanwhile, is up 15% so far this year. *–Tara Kalwarski*



FIXED INCOME

A GAME PLAN FOR BONDS

By Tara Kalwarski

Last year was one of the best showings for bonds in more than a decade: Ibbotson Associates' index of long-term government Treasuries returned 26%. In the first eight months of 2009, however, the index lost 11.5%. Bad news for investors, who poured almost $210 billion of new money into fixed-income funds over the same period, vs. $32 billion in net inflows for the whole of 2008.

"The last year has really highlighted the risky side of investing within fixed income," says Steven Huber, a fund manager at T. Rowe Price Group. Since 1997 the only fixed-income categories that haven't experienced losses over 12-month periods are shorter-term Treasury funds—which are often lumped in with a fund's cash. A Barclays Capital index of high-yield bonds has lost more than 31% in a 12-month period (table). And even an index of the highest-quality bonds has had a year when losses approached double digits.

With jittery stock market investors putting money into bonds, here's a refresher on the fundamental rules of building a sound bond portfolio.

RULE 1 Sticking to basics doesn't mean staying at home. Core bond holdings don't have to consist solely of U.S. Treasuries and investment-grade corporate bonds. "Investors should have allocations to global bonds as well," says ING portfolio manager Chris Diaz. Over the past dozen years, global debt has returned an average of 5.7% a year. Diaz says the sovereign debt of AAA-rated countries currently boasts significant yield advantages over U.S. Treasuries.

RULE 2 Settle for singles. Among Fidelity's target-date retirement funds, not one allocates much more than 10% to high-yield bonds. "You're not looking for your bond portfolio to hit a home run," says Lowell Bennett, a bond fund manager at Mellon Capital Management. "Consistent singles are good."

RULE 3 Stick to funds. Individuals are best off buying funds, not individual bonds. "I don't know that the average investor is even going know what he's looking at," says Ethan Anderson, a portfolio manager and financial adviser at Rehmann Financial in Grand Rapids, Mich. And if you need to sell a bond before it matures, there's no guarantee you'll find a buyer—and no telling what price you'll get.

An investor's ideal fixed-income mix depends, as with stocks, on risk tolerance and time horizon. A resource for figuring out how much and what type of fixed income you may want is fidelity.com/fixedincomechoices. Searching Morningstar.com can uncover cheap, highly rated bond funds with low volatility. BW

TOTAL RETURN SINCE 1997*

BOND CATEGORY	WORST 12-MONTH PERIOD		ANNUAL AVERAGE	BEST 12-MONTH PERIOD	
LONG-TERM U.S. TREASURIES	–9.0%	JAN. '99-DEC. '99	7.8%	JAN. '07-DEC. '08	25.9%
LONG-TERM CORPORATE	–14.9%	NOV. '07-OCT. '08	7.2%	JUNE '02-MAY '03	22.6%
INTERMEDIATE-TERM U.S. TREASURIES	–2.8%	FEB. '99-JAN. '00	6.1%	APR. '02-MAR. '03	15.0%
GLOBAL DEBT	–9.9%	NOV. '99-OCT. '00	5.7%	APR. '02-MAR. '03	28.9%
HIGH-YIELD CORPORATE	–31.2%	DEC. '07-NOV. '08	5.7%	NOV. '02-OCT. '03	33.8%
MUNICIPALS	–8.6%	FEB. '99-JAN. '00	5.6%	FEB. '00-JAN. '01	19.0%
30-DAY U.S. TREASURY BILLS	+0.3%	SEPT. '08-AUG. '09	3.3%	FEB. '00-JAN. '01	6.0%

Data: Ibbotson Associates *As of Aug. 30, 2009

ILLUSTRATION BY JOHN HERSEY

THE STOCK MARKET

SEARCHING FOR TRUE NORTH

(FROM PAGE 040)

By Dean Foust

Every decade or so, investors are told to heed a new megatrend, whose chief appeal is, well, its newness. In the '90s, investors were sold on the notion of a New Economy that wasn't subject to the old laws of gravity and, among other things, could support higher stock valuations. And one of the best-selling investing books of the past decade was *The New Investment Superstars*, a tome that canonized a new breed of fund wizards, some of whom later proved to be mortal. Now comes the latest investment fad, the "new normal," the idea championed by Pimco bond guru Bill Gross that the U.S. has entered a period of diminished expectations that requires investors to rethink their long love affair with stocks.

There's a certain Biblical undertone to the new normal orthodoxy: After decades during which consumers lived beyond their means, the nation must now endure a long stretch of lean years during which consumers pay down debt. In the minds of Gross and Pimco colleague Mohamed El-Erian, the prospect of a period of no growth means investors should hold as little as 30% in stocks, vs. the 60% long deemed the proper mix. They also recommend holding more fixed-income assets like bonds and bank loans, as well as commodities.

The risk for investors is that the new normal proves to be merely the latest investment fad, and by moving into bonds they miss future rebounds in stocks. "The new normal is just a different way of saying 'It's different this time,' and that's often a recipe for disaster," argues Barry Ritholtz, chief executive officer of Fusion IQ, a quantitative research firm. "The mathematician in me says we're just reverting to the mean." Ritholtz believes the U.S. will recover, but it may need years to work off its 25-year debt binge. He sees "a lot of parallels" between now and the 1973-74 recession, a downturn he says that serves as a good composite of the 19 previous bear markets. Then and now, the market fell more than 45%, then rebounded 60% to 70% (chart). If past is prologue, Ritholtz thinks there could be another leg down, a few years of treading water—and a powerful bull market starting around 2012 or 2013.

A NEW BALANCE

Ritholtz and other pros believe the best strategy for many investors may be to beef up stakes in fixed-income and alternative assets but maintain enough exposure to stocks to profit from the rally the "old normal" crowd believes is inevitable. Robert Arnott, head of Research Affiliates, a research and analytics firm in Newport Beach, Calif., thinks investors would do well to build a portfolio split into five even baskets: U.S. stocks paying healthy dividends, stocks and bonds from mature foreign economies, stocks and bonds from emerging markets, stocks and bonds built around oil and other commodities, and 20% in bonds, including Treasury inflation-protected securities, which pay a return based on inflation. He suggests owning some "assets that other investors are afraid of" in each basket, such as high-yield bonds.

Arnott's approach gives investors a roughly 50% weighting in stocks, but that comes from economies that could grow faster than the U.S. And it incorporates exposure to commodities that should fare well in any rebound—and provide a hedge against a surge in inflation. It's a portfolio that could produce the best of both worlds: a blend of assets that generates income during lean times but provides upside if the new normal isn't so new after all. |BW|

IF THE PAST IS PROLOGUE...

Analyst Barry Ritholtz see parallels between today and the 1973-74 recession, which he says argue for a powerful rebound around 2012



Data: Bloomberg, *BusinessWeek*

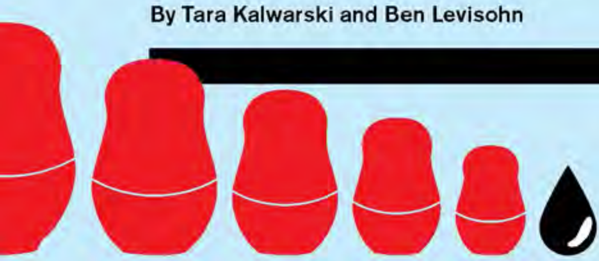
CHART BY ALBERTO MENA/BW

COUNTRY REPORT

THE PERIL AND PROMISE OF INVESTING IN RUSSIA

(FROM PAGE 048)

By Tara Kalwarski and Ben Levisohn



The Russian economy is heavily dependent on energy and mining, so when oil plunges, the Russian stock market does, too. But for investors looking to gamble on this emerging juggernaut—the country's Micex index has returned an average 23% a year since launching in 1997—there are a couple of widely available fund options.

NOT FOR THE FAINTHEARTED

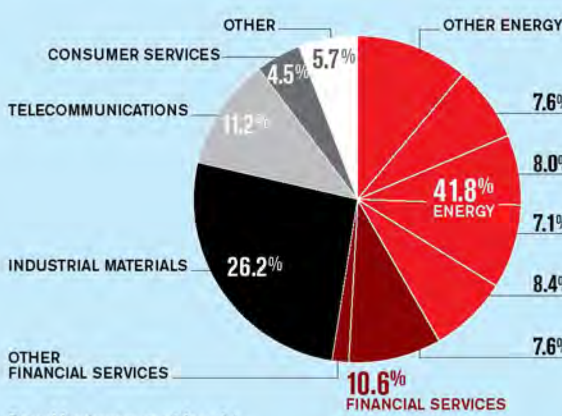


Data: Bloomberg

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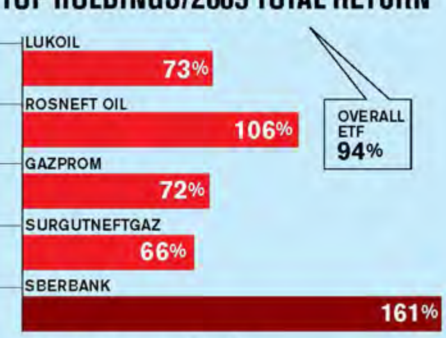
AN OIL-SOAKED ETF

Almost half of the Market Vectors Russia ETF is composed of energy companies, including four of the top five. Among that group, however, the lone financial company is the top performer.



Data: Morningstar as of Aug. 31

TOP HOLDINGS/2009 TOTAL RETURN



Data: Bloomberg as of Sept. 22

FROM RUSSIA, WITH RISK

The volatile returns of the three U.S. mutual funds that focus almost exclusively on Russia have resulted in high risk ratings from Morningstar.

FUND/TICKER	RUSSIA ALLOCATION	TOTAL RETURN 2009*	TOTAL RETURN 2008	COMMENT
ING Russia A/ LETRX	98%	101.8	-69.1	This fund's highly concentrated portfolio gives it the potential for outsize gains—and added risks, including political instability.
Third Millennium Russia/TMRFX	93	87.0	-74.4	A 2.75% expense ratio makes this the priciest Russia-themed offering, but it ranks near the top of its category for the past 10 years' performance.
JPMorgan Russia A/ JRUAX	83	123.8	-78.2	Since its inception in February 2007, this fund has lost an average 17% a year. Year to date, however, it ranks in the top 3% among its peers.

*As of Sept. 22 Data: Morningstar, Bloomberg

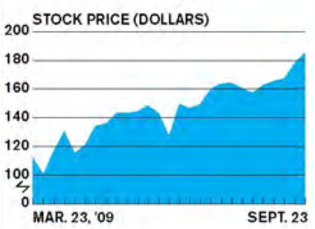
ILLUSTRATON BY TAMARA SHOPSIN



RUNNING ROOM AT GOLDMAN

When Goldman Sachs rocketed to a 52-week high of 185.52 on Sept. 22, some pros warned that it had hit a peak—to be followed by a drop. Don't count on it, assert the bulls, saying Goldman Sachs (GS), now at 183.64, is a long way from its 2008 high of 215 and its all-time record of 250 in 2007. With this in mind, some big investors have become more bullish. "With $20 a share of potential earnings in two years or less, the stock is still attractively valued," says Karl Mills of Counterpoint Select Fund (it owns shares), who sees Goldman at 240 in a year or two. It earned just $4.47 in 2008 because of trading losses and a drop in investment banking activity during the crisis. "Goldman's superior business model—focused on proprietary trading, investment banking, and asset management—has pushed it way ahead of its peers," says Mills. And now that banking and merger activity has picked up, "Goldman stands to benefit and capture the lead in many equity deals," he adds.

GOLDMAN'S GOLDEN GLOW



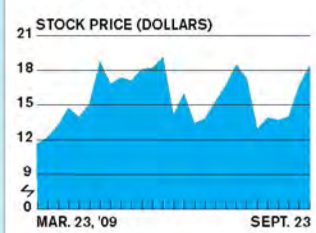
Data: Bloomberg

Matthew Albrecht of Standard & Poor's says the stock's continued advance reflects Goldman's global reach, operating leverage, and solid balance sheet. He rates it a buy, based on his profit forecasts of $17.12 a share in 2009 and $18.40 in 2010. Goldman's robust financials, he says, give it an edge in gaining market share in the economic recovery.

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POISED: PETROLEUM DEVELOPMENT



Data: Bloomberg

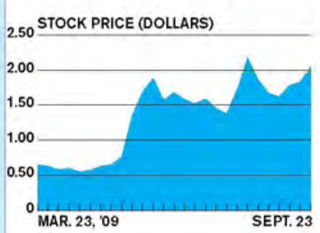
Drilling in Promising Spots

Shares of Petroleum Development (PETD), a little-known, independent oil-and-gas outfit, aren't showing much energy, stuck between 16 and 18 since May. But the stock, now at 18.46, may perk up: It has caught the eye of big investors who call it one of the best values in the oil patch.

"With a yearly production growth rate of 12% and book value of 27, the stock at its current depressed price of 18 is a giveaway," says Scott Black, president of Delphi Management, which owns shares. Black says Petroleum Development is worth 53, based on its reserves, which consist of 81% natural gas and 18.5% crude oil. The company drills primarily in the Rockies, the Appalachians, and Michigan.

John Gerdes of SunTrust Robinson Humphrey, who rates Petroleum Development a buy, sees earnings of 54¢ a share in 2009 on revenues of $363 million, and 61¢ in 2010 on $431 million.

ZIOPHARM ONCOLOGY RISES



Data: Bloomberg

An Undervalued Biotech?

Biotech stocks have rallied lately, but they're still below their historical highs. One undervalued outfit, says Chrystyna Bedrij of Griffin Securities, is Ziopharm Oncology (ZIOP), whose shares have jumped to 2.06 from 50¢ in May. One major product, Zymafos, a sarcoma treatment, showed favorable results in phase I and II trials last year, with a potential market of $400 million, says Bedrij. (Griffin did business with Ziopharm). A phase III trial is set for 2010.

Another Ziopharm drug, Zinapar, showed efficacy for T-cell lymphoma and "was well tolerated" by patients in recent trials, reports James Armitage, professor of oncology at the University of Nebraska and past president of the American Society of Clinical Oncology. Simos Simeonidis, senior biotech analyst at Rodman & Renshaw, says Ziopharm is undervalued, thanks to a "very promising" pipeline |BW|

BRAD TRENT; CHARTS BY DAVID FOSTER

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OUTSIDE SHOT | CHRISTINE LAGARDE

Financial Reform: No Time to Pull Back



France's Finance Minister says the crisis is easing, but it's far too soon to declare victory

One year ago, Lehman Brothers filed for bankruptcy, and the world fell into the worst economic crisis since the Great Depression. A few weeks after the bank failed, the Heads of State and Government of the Group of 20, representing 85% of the world's wealth, met in Washington to assess the task that lay ahead. In April 2009, they met again, in London, to draw up a road map for the steps to be taken to prevent such a crisis from ever happening again.

To use another metaphor, at this point, after intensive care (a set of coordinated stimuli), the patient seems to be out of danger. Now comes the second phase of the treatment: lancing the wound that still infects the markets and sickens the global economy.

When the G-20 emerges from its Sept. 24-25 meeting in Pittsburgh, its goal must be to fully implement the decisions we made back in April: to improve supervision and standards of prudence to prevent excessive risk-taking by financial operators; to regulate hedge funds and credit-rating agencies; and to address the issue of securitization, one of the contributing factors of the onset of the crisis.

This is not just a matter of being true to our word. It is the best guarantee of moving forward to recovery.

Already there are signs of improvement on the economic front and in financial markets. In Europe, some countries—France and Germany among them—enjoyed positive growth in the second quarter. The Chinese economy is increasingly showing signs of renewed dynamism. Confidence is returning to the banking sector.

At the same time, this upturn has led some to think we can go back to business as usual, that financial-sector reform can wait for another day. Such an attitude cannot be tolerated.

It deliberately ignores the fact that public authorities around the world—taxpayers, in other words—stepped in with massive injections of capital when the crisis was at its height. It also ignores this fact: We will be able to put the economy on the path to sustainable growth only by dealing with the roots of the crisis, through a profound reform of the financial system.

And if we are to reconstruct international financial regulation, we must

ANDREW WINNING/WPA POOL/GETTY IMAGES; ILLUSTRATION BY MATTHEW HOLLISTER



Points of view among G-20 members may differ when it comes to bonuses. But tackling the issue is unavoidable, Lagarde says

do so quickly and forcefully. With so much at stake, "It can't be done" is not an acceptable response.

At a meeting in London in early September, G-20 finance ministers unanimously decided to present two recommendations to the Pittsburgh gathering. The first: to continue to support the global economy as long as the recovery has not fully taken hold, while beginning discussions about exit strategies. The goal should be to successfully complete recovery efforts so that 2010 can be—as the International Monetary Fund has given us to hope—a year of positive global growth. Suddenly pulling away needed support and prematurely claiming victory would dash this hope.

The second recommendation: to implement all of the G-20's April 2009 decisions with respect to financial sector regulation— and even to strengthen them in certain areas.



When it comes to bonuses, the ultimate symbol of a possible return to past excesses, our shared goal is not to reward excessive risk-taking but to restore a legitimate search for product innovation and to do away with the reckless conduct of some traders who put our financial system in jeopardy. In *The Wealth of Nations*, Adam Smith argues for something similar, noting that moderation is necessary for the market to function in the long term.

At the end of last month, France unveiled a series of rules on compensation for market players. These include a provision for bonuses to be stretched over three years (so there is time for performance to be taken into account), the payment of one third of a bonus in shares, and a way to "claw back" a bonus in the event of a bank's negative performance. In Pittsburgh, France will argue for strict, globally accepted, and universally applied rules on compensation to put an end to the excesses and greed that once characterized the financial sector.

I know that points of view among G-20 members may differ when it comes to bonuses. But I also know that since we share the same objective—to rebuild a financial system on a sound basis—tackling the bonus-culture issue is unavoidable.

Whether we are talking about enhanced requirements for financial prudence or fighting offshore tax havens, we have accomplished a lot since the last G-20 meeting. Washington 2008 was the G-20 summit of principles. London, that of decisions. In Pittsburgh, we must show that we can change the system for the better because, ultimately, it is in everyone's interest. Transparency, responsibility, and supervision are the keys to avoiding another financial meltdown. |BW|

Christine Lagarde is the French Minister for the Economy, Industry & Employment.

Business Exchange

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Good Intentions, Bad Outcomes

From Pittsburgh to Washington to Paris, a debate is raging on how to tame excessive executive pay. But compensation expert Graef Crystal reminds advocates of government regulation that in the U.S., at least, some attempts at reform have fallen flat or even backfired. Specifically, he cites the introduction in 1993 of a rule that limits the corporate tax deduction for executive pay to $1 million. Yet salaries have climbed. Crystal found that of the 355 CEOs at U.S. companies with market caps of $5 billion or more, 55% collect a salary of more than $1 million. What's more, the Clinton-era legislation—which applies only to base salaries—may be partly to blame for the trend in recent years toward oversize bonuses for chief executives.

For Crystal's and others' insights on the topic, go to **http://bx.businessweek.com/executive-compensation/**



Windows Upgrades Made Easier

PCmover transfers programs and files to the new operating system with fewer headaches

Upgrading a Windows PC is hard. As I noted in a recent column, only a relatively small number of computer owners will be able to upgrade to Windows 7 in a way that leaves all of their programs intact. Buying an new computer instead doesn't really improve things; you still have to find and reinstall all of your applications.

PCmover from Laplink can greatly ease the pain. It's not perfect (plan on some fiddling to get everything working right after using it either for an "in-place" upgrade or to set up a new PC). But it is a huge improvement over Microsoft's built-in option, Windows Easy Transfer, which moves files and settings but not programs.

Window users can only envy Mac owners, since Apple sets the gold standard for ease of upgrading. Unlike the limited Easy Transfer, Mac's Migration Assistant is a dream. You run it when you get a new Mac and it finds the old Mac on your network, transfers all its programs to the new machine, and moves your preferences and data. For a variety of technical reasons, Windows programs are much harder to transfer, and Microsoft has never offered much help.



Maybe Laplink succeeded at this task because the company has been making file-transfer programs since the earliest days of laptops. PCmover comes in three versions: a $20 edition that will help you upgrade from Windows XP to Windows 7 on an existing computer; a $40 version called PCmover Home that can handle either an upgrade or a transfer to a new computer (the right choice for most people); and a $60 Professional edition offering more control over what is moved, especially on computers used in a corporate setting.

I tried PCmover under a variety of scenarios, including upgrading a computer from XP to Windows 7, transferring applications and files from an XP computer to a new Windows 7 PC, and upgrading from 32-bit Vista to 64-bit Windows 7. (See my recent column on Win 7 upgrades, http://bit.ly/11BTiS, for more on 32-bit vs. 64-bit.) Each of these setups ran into glitches of one sort or another, but in every case PCmover made the process easier.

When upgrading an existing computer, PCmover stores the information it will transfer on the built-in hard drive or an external drive. When setting up a new computer, the easiest method is to link your new and old machines with a special USB cable ($40, but included with the Pro version).

Laplink's program isn't perfect, but it works. The question remains: Why doesn't Microsoft make migration easier?

Some applications, especially antivirus programs, are designed to run on a specific version of your operating system and cannot be moved. Other applications will take a bit of fussing on the new computer. For example, PCmover transferred Microsoft Office, both the 2003 and 2007 versions, under all the scenarios so that mail accounts in Outlook and preferences in other programs showed up on the new or upgraded systems. But I had to find and reenter a 25-character installation key to activate Office. A word to creative types: Adobe's professional programs, such as Photoshop, should be deactivated on the old computer before moving or upgrading, or you may have trouble getting them to work on the new system.

It's a bit of a mystery why Microsoft hasn't done more to make migration to a new version of Windows easier. After all, it makes money on Windows only when you buy a new computer or upgrade from an older version. It's equally surprising that computer makers haven't stepped up to the plate, since making it easier to transfer your stuff to a new system might just make people more willing to buy computers. When you're spending $120 for a Windows upgrade or several hundred dollars or more for a new computer, you shouldn't have to pay extra for a tool to set it up. But grousing aside, I'm glad PCmover is around to make the chore easier. |BW|

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MANUFACTURING

MAKING IT IN AMERICA

"Can the Future Be Built in America?" (Cover Story, Sept. 21) said the U.S. may no longer have the manufacturing expertise to launch the high-tech industries invented on its soil. A few readers blasted this stance—one deeming it "hysteria." But many others had ideas about how to reverse the trend. Reducing taxes on companies would be a good start, some wrote. Another proposal: Learn from today's experts, including U.S.-based Japanese carmakers. *—Pete Engardio*

Think about the cost of OSHA compliance, workers' compensation, liability insurance, medical insurance, minimum wage, paid vacation, paid holidays, paid maternity leave, payroll taxes, taxes on inventories, and taxes on buildings and land. Millions of manufacturing jobs have moved outside the U.S. because other countries don't have these explicit and hidden costs.

George Koeninger
KINGWOOD, TEX.



The race is far from over. New York State invested $1.2 billion in incentives to help build the world's largest, most advanced semiconductor manufacturing facility. Global Foundries' Fab 2 is bringing more than 5,000 jobs to eastern New York's tech valley.

Seth Buchwalter
SARATOGA SPRINGS, N.Y.

Manufacturing can be done successfully in America. Look at the Japanese [carmaker] transplants: They chose low-cost places to invest in the U.S.

Screen name: Hugo van Randwyck

This article repeats the usual hysteria about "the loss of American manufacturing." What tripe. The U.S. produces nearly one-fifth of the world's products; our manufacturing output is just fine.

Screen name: Ogee

GREEN LIVING

CONVERTING TO A CARBON-FREE LIFESTYLE

My goal is to reduce my footprint as much as Michelle Conlin and her husband did ("A No-Carbon Payoff," Personal Business, Sept. 14). With three kids under 4 and a husband who is "high-impact and proud of it," I have my work cut out for me.

Alicia Webster
WINCHESTER, VA.

CORPORATE CULTURE

ONE FACTOR THAT MAY STIFLE TALENT

Regarding "Where Headhunters Fear to Tread" (In Depth, Sept. 14): Just after phone deregulation in the 1980s, I was at Pacific Telesis. The culture was so stodgy that those of us who hadn't joined out of high school were "outsiders." We feared that if we learned to fit in, we'd lose our ability to think. Maybe companies starting as highly regulated industries have trouble producing talent.

Joy Hahn
SAN FRANCISCO

R&D

IBM'S CANADIAN COLLABORATION

Big Blue's Global Lab" (Cover Package, Sept. 7) failed to mention IBM's plant in Bromont, Quebec, part of a "microelectronics corridor" stretching from East Fishkill, N.Y., that provides 35,000 well-paying IT jobs. Part of a new partnership with the governments of Quebec and Canada, the plant is a prime example of economic integration between Canada and the U.S.

Robert Keating
Quebec's Delegate General
NEW YORK

CEO COMPENSATION

HOW THE MEDIA HELP INFLATE PAY PACKAGES

Regarding "CEO Pay: Is It Still Out of Sync?" (New Business, Sept. 7): One reason for rocketing CEO compensation is the media's publicizing and ranking of executive pay. Do CEOs know where they rank? I'll bet it's burned into their brains.

Erwin Molnar
BELLEVUE, WASH.

CORRECTIONS & CLARIFICATIONS

"100 Best Global Brands" (Cover Story, Sept. 26) gave incorrect data for Samsung's brand value. It is $17.5 billion in 2009, down 1% from $17.6 billion in 2008. The ranking also omitted a minus sign in the percent-change column for Citi's brand value, which slipped 49%. A photo caption with another article in the package, "Panasonic Puts Its Chips on 3D TV," mistakenly identified Yoshi Yamada as Panasonic's CEO. He is CEO of North American operations. Fumio Ohtsubo heads global operations.

Extraordinary Women, Familiar Advice

Tales of trailblazers in business and politics are inspiring, but the authors' "groundbreaking" findings are not

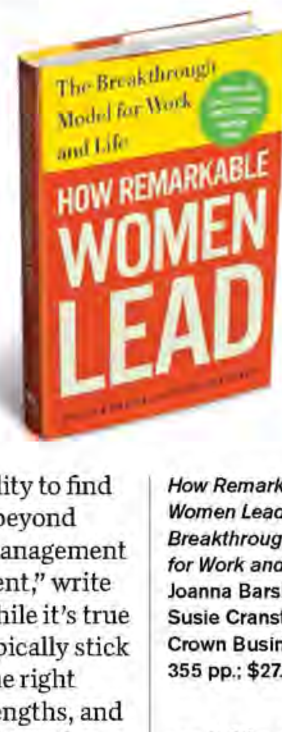
Avon Chairman and CEO Andrea Jung has a plaque she keeps behind her desk that depicts four footprints: that of an ape, a barefoot man, a wingtip shoe, and finally a high heel. It once belonged to her predecessor and mentor, Jim Preston, who told her early on that "one day a woman will run this company—a woman should run this company."

The day Jung became CEO, Preston gave it to her. "The idea is the evolution of leadership," Jung says.

Encapsulating the way notable women rise to success is the stated goal of *How Remarkable Women Lead* by McKinsey consultants Joanna Barsh and Susie Cranston. Besides Jung, the authors interviewed Time Inc. Chairman and CEO Ann Moore, French Finance Minister Christine Lagarde (page 78), and Xerox Chairman Anne Mulcahy, among many others. The book is packed with revealing anecdotes from women in high places.

The stories are often inspiring, but Barsh and Cranston fall short of persuasiveness when they argue that their "Centered Leadership" model is "groundbreaking," as the book-jacket flap claims. And they could have made more of the five years of proprietary research data they promote on the cover. While it's refreshing to see a leadership book directed at women when just 3% of large U.S. corporations are run by them, this one has, at times, a self-help tone that may turn some readers off.

Barsh and Cranston began their research by interviewing more than 100 high-achieving women, mostly in business, academia, and government. They noticed common factors that led to the women's success. After conducting additional surveys and studying academic research, the authors boiled down their findings to five common traits. Top women leaders manage their energy well, find meaning in their work, excel at framing problems and solutions, connect with many colleagues and "sponsors"—mentors in senior positions—and engage deeply in their jobs. Taken together, the authors call this system Centered Leadership and use it for development programs at McKinsey. The book is structured around examples, anecdotes, and tips for achieving Centered Leadership.



***How Remarkable Women Lead: A Breakthrough Model for Work and Life* by Joanna Barsh and Susie Cranston; Crown Business; 355 pp.; $27.50**

Traits such as being energetic and having an ability to find meaning in one's work "lie beyond traditional approaches to management and professional development," write Barsh and Cranston. And while it's true that books on leadership typically stick to topics such as building the right teams, focusing on core strengths, and communicating a clear strategy, the elements in this "model" will feel like common sense to some readers. Those who have read popular management thinkers such as positive-psychology expert Martin Seligman, Claremont Graduate University psychologist Mihaly Csikszentmihalyi, and best-selling "energy management" gurus Jim Loehr and Tony Schwartz will also find some of this material familiar. To distinguish their book, the authors could have delved deeper into the similarities and differences between male and female leaders found in their proprietary research. Instead, their extensive data mostly appear in an appendix.

A self-help tone and insights that seem like common sense detract from the book's trove of revealing anecdotes

How Remarkable Women Lead is best suited to female managers looking for lessons from others' routes to the top. There's a breath of fresh air in the candor of Axis Bank CEO Shikha Sharma's embarrassing tale of a deputy's jihad-themed sales program when she was at India's ICICI Bank, which landed her in hot water, and in former Qantas Chairman Margaret Jackson's recounting of a botched interview she gave while in the hospital and on medication. Some revelations are both reassuring and amusing: Ann Moore says "forget perfection and balance!" in recalling her failed attempt to be both a media exec and a producer of homemade baby food.

Still, the book occasionally reads like *Chicken Soup for the Female Leader's Soul*. In explaining their Centered Leadership concept, Barsh and Cranston tell readers: "Feel the gravity beneath your two feet holding you steady as you stretch to the sky" and are given to such phrases as "Laugh for the fun of it!" and "We're here to help you on your way." Those who can look past such tropes should end up inspired by the truly remarkable women in *Remarkable Women*. But those looking for surprising secrets of their success are likely to be left wanting more. |BW|

COMPANY INDEX

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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The No-Cost Way to Motivate

A manager's genuine interest in employees' lives pays off at every level, in every job

"Now listen to me, all of you. You are all condemned men. We keep you alive to serve this ship. So row well, and live." Those were the words of Quintus Arrius in the movie *Ben-Hur*. And while he was speaking to Roman slaves, one can almost imagine a modern version coming from a manager today. "O.K., people, you all know that unemployment is at a 50-year high. You're lucky to have jobs. So work hard, and no more complaining."

Lost amid the justifiable concern about the 9.7% of U.S. workers who are unemployed is the well-being of the other 90.3%, many of whom are miserable. They feel they're out of options and that management has little incentive to make their work lives more meaningful.

Even well-intentioned managers—as most are—feel their hands are now tied when it comes to motivating and engaging their workers. Salaries are stagnant. Perks and benefits are only going to get slimmer. What can they do?



Plenty—and one important way to motivate and engage your team is just as available and cost-effective as it has always been. Perhaps it's overlooked because it's so ridiculously simple; it's something even the worst managers get and the best ones can forget. In fact, I am reluctant to write about it here because it is so patently obvious. But then I think about that quote from 18th century writer Samuel Johnson: "People need to be reminded more often than they need to be instructed."

So here's a reminder for managers: Take an active, genuine interest in the lives of your employees. (And since I'm doling out obvious advice, don't forget to wash behind your ears.)

One of the greatest causes of misery for employees is the feeling that the person they work for isn't interested in who they are and what goes on in their lives, personally or professionally. Regardless of how much money people make and whether their jobs suit them, if they feel anonymous they'll dread going to work—and return home deflated.

I see this in every industry, at every level. One woman I know of had a great job at a nonprofit she loved, so she was at a loss to explain why she felt unfulfilled. After she had her first child and returned to work, she realized why: For two months her manager failed to ask her about the arrival of her baby, the most important event in her life.

A manager needs to be interested in employees from a professional standpoint, too, not only in job details but also in motivation. And a big part of this is helping people figure out why their job matters to someone, somewhere, in some way large or small. For a brain surgeon, firefighter, or priest this is obvious, but for an accounts payable clerk or a pizza delivery guy, it requires a bit more thought. It's essential, however, to finding fulfillment at work.

It's amazing how many high-profile, highly paid employees are as miserable as anyone else when their managers don't seem interested in them. Take, for instance, professional football players. Based on my work with NFL teams, I can attest that misery is alive and well among the players. Most fans can't understand. After all, these athletes are paid exorbitant salaries for playing a child's game for half the year.

Anonymity certainly shouldn't be the cause. Fans and the media dote on the players. But it's an employee's manager who needs to take an interest—and that doesn't happen often in the NFL. A few years ago I spent time with an NFL head coach who had just traded for a talented but troubled player. When I asked the coach, a remarkably decent guy, if he would get to know the new player, try to understand what made him tick, he said: "Nah. This is pro ball, Pat. We're adults. This is a job." The player was 24 years old.

Even among executives, I find that anonymity is a bigger problem than many will admit. So many CEOs and top executives convince themselves that the senior managers they hire are big boys and girls who don't need to be managed like employees anymore. They're shocked to find out later, often after someone leaves, how much their personal detachment affected that employee's work experience.

The truth is, whether we're managing executives in a global technology company, linebackers in the NFL, or rowers in the hull of a ship, if we can't find a way to take an interest in our employees as people, we're committing them to a miserable work life. And that makes ships go a lot slower. |BW|

Patrick Lencioni is the author of several books, including The Three Signs of a Miserable Job *and* The Five Dysfunctions of a Team, *and is the founder and president of management consultancy The Table Group.*

Jack and Suzy Welch are off while Jack recovers from a back infection.

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